INDUSTRIAL CONSOLIDATION

PART II

Reading # 16

THE EFFECT OF OPEN PRICE ASSOCIATION ACTIVITIES ON COMPETITION AND PRICES

In the American Economic Review for June, 1917, there appeared an article entitled "Open Price Associations" in which the author, Professor H. R. Tosdal, discusses the historic and organic origin of these associations, their prevalence, structure, functions, legal status and probable effect on prices. In this article the purpose is to consider the more theoretical aspects of the open price movement, particularly as it pertains to the competitive price-making forces.

For the benefit of those who may have no acquaintance with open price associations and their functions, it may be observed that they are in the nature of trade associations which place special emphasis on putting at the disposal of members business information, chiefly of a statistical character, calculated to give the membership an intimate acquaintance with competitive conditions as they exist among themselves and in the industry as a whole. The business facts most commonly exchanged are those relating to prices actually quoted or charged, terms of payment, manufacturing and selling costs, purchases, stocks on hand, volume of production, orders, shipments, inquiries, bids, contracts, cancelations, advertising and credits. In most cases secretaries elected by the membership do the work of assembling, compiling and disseminating this information. Meetings are held at frequent intervals to give members an opportunity to discuss all matters of interest bearing on the problems of their industry. Particular attention is likely to be given in these meetings to such factors as affect the supply and demand situation, chief among these being the prices actually quoted or charged, amount of stocks on hand, volume of production and shipments, trend of orders and the like. In properly conducted open price organizations, each member acts independently of every other member in the determination of his price and production policy. Of course he is influenced by the written reports that he receives as well as by the discussions that he hears in meetings, but these reports are carefully limited to statements of fact throwing light on actual conditions existing in the industry and no attempt is made either directly or indirectly to get members to react to this information in such a way that uniform results in the matter of production and price policy will be brought about in the industry. In other words, members are left entirely free to place any interpretation they please upon information received.

This, at least, is the construction placed upon the plan by its founder, Mr. Arthur J. Eddy, who began organizing open price associations on this principle as early as 1911, particularly in the iron and steel, textile and lumber industries. For several years prior to his death he had been making a study of the law as it pertained to the various forms of industrial combination. Especially had he taken note of Mr. Gary's experience in attempting to stabilize the iron and steel industry by building up among competitors a spirit of cooperation through the instrumentality of the so-called Gary Dinners. He was quick to see the benefits of this cooperation provided it could be directed in such a way as to result in no violation of anti-trust laws. In studying this aspect of the situation he conceived the idea that there could be nothing illegal in permitting competitors to exchange

information dealing with closed transactions. His observation of the workings of the Gary Dinner system convinced him that understandings in violation of law inevitably followed upon the heels of discussions devoted to a consideration of future prices, production policy and the like, but that exchange of information dealing only with past transactions could never be construed as being in the nature of understandings in contravention of law.

To date, at least, the open price associations that have been organized and operated under the direction of Mr. Eddy or his successor in the practice of law, Mr. Mathews, seem to have weathered the searching glances aimed at them by the law enforcement branches of the federal government and the various state governments. But the unsavory character of the activities of certain so-called "open price associations" disclosed by the Lockwood Committee in its investigation of the building trades in New York City, together with the unfavorable decision handed down by the United States Supreme Court in the case of the American Hardwood Manufacturers' Association, has had the effect of throwing the entire open price movement into disrepute--at least as far as the general public is concerned. Without attempting to pass upon the legal merits of open price activity, it may be said without fear of contradiction that legal opinion on the subject is practically at one in the belief that no principle of law and no final judicial decision condemns the formation and maintenance of an association of independent business competitors, each of whom remains free in the conduct of his business, where the purpose is to assemble, compile and disseminate information of common interest. When, however, information of this character is used to bring about agreements or understandings in restraint of trade, no matter how indirect the means of bringing them about may be, the activity so engaged in will undoubtedly all under tha ban of the law. It seems clear that in the recent so-called "Hardwood case," involving the American Hardwood Manufacturers' Association, the Supreme Court did not lay an embargo on members of a trade association assembling, compiling, and disseminating price and trade data amongthemselves. If the activities of this association had not gone beyond this point, it is thought that their open price plan would not have been condemned by the court. But the dissemination of data was accompanied by suggestion, advice and opinions on the part of the manager of statistics, calculated, as the court saw it, to bring about harmony of action in price and production policy. The court, then, objected to the manner in which the members of the American Hardwood Manufacturers' Association interpreted and administered their particular so-called "Open Competition Plan," the decision being that members intended to use the plan to restrict production, enhance prices, and unreasonably restrain free competition in interstate commerce. As previously intimated there is nothing to indicate that open price activity is necessarily in and of itself illegal. It seems clear that the court will always consider the merits of each case as it comes up for consideration and the nature of the decision will doubtless hinge on whether or not is deemed that the exchange of information has been used as an instrumentality for achieving restraint of trade.

T he character of true open price work as defined and promulgated by its founder, Mr. Eddy, having been explained, the ground is cleared for a consideration of the place occupied by the open price movement in our economic life. On the assumption that free competition in trade is the condition of trade most conducive to public welfare, is the open price movement likely to assist in giving proper play to competi-

In trust - you give up rights but not ownership

tive forces in industry or is it likely to prove an impediment?

In his book entitled New Competition, Mr. Eddy, the founder of the open price plan, advances the thesis that truly competitive conditions can exist only when competitors are in possession of all facts having a bearing on the competitive situation, including such matters, for instance, as accurate knowledge of the volume and character of production, stocks, orders, the nature and trend of costs, prices and the like. His contention is that the possession of adequate knowledge of all facts bearing upon the competitive situation is the very essence of competition. Competition, conducted as it is today in most industries by relatively ignorant competitors, is, according to Mr. Eddy, properly speaking not competition at all. Ignorance among competitors is largely responsible fot eha nimosity, fierceness, brutality, ruthlessness, destructiveness and wastefulness characteristic of industrial enterprise as it is conducted today, he adds.

Mr. Eddy's statement that "the essence of competition lies in the element of knowledge" and that "it is real, true and beneficial in proportion to its openness and frankness, its freedom from secrecy" is not new doctrine in economic literature, although to the thinking of the writer its true portent has not been adequately emphasized in speech or writing. Economists have long taken cognizance of the fact that innumerable elements of friction are ever present under actual competitive conditions to prevent the law of supply and demand from working itself out as it would if they were not present. Ignorance has been recognized as one of the deterrents to an approach to a condition of free competition. In fact economists, in formulating the law of supply and demand (which, of course, lies at the basis of commercial competition) have made the explicit reservation that the law only holds if it is assumed that all interested parties are intelligent enough to know their own interest and are able and ready to act thereon. Obviously they will not be alive to their interests if they are not acquainted with all the conditions affecting the supply of and the demand for the particular commodity in which interest is centered.

Mr. Eddy does not make clear why he thinks that knowledge is the very essence of competition. The statement is undoubtedly very significant when proper interpretation is put upon it. Its importance (as the writer sees it) lies in the fact that a knowledge on the part of sellers and buyers of their own interest, implying as it does, a knowledge of all conditions that have bearing on the supply of and the demand for, a given commodity, together with the ability and willingness to act intelligently thereon, will result, according to the law of supply and demand, in similar exchanges taking place on similar terms; or to state it in terms of price, it will result in the naming of an equilibrium price "for the same unit of the same quality of the same commodity in the same market." This stability of market conditions which finds expression in a single price will ensue only under the conditions named. It is attainable only in theory. But such stability can presumably be approximated by putting forth systematic efforts looking toward the eradication of sources of friction. Undoubtedly one of the most serious sources of friction is due to sellers and buyers lacking adequate knowledge--that is, knowledge so systematized as to make clear just what business policies the competitive situation demands.

The nearest approximation in actual life to a stability of conditions such as is attainable theoretically seems to have been achieved

give forces in industry or is it likely to prove an impediment?

In his book entitled New Competition, Mr. Eddy, the founder of the open price plan, advocates the idea that only competitive conditions can exist only when competitors are in possession of all facts having a bearing on the competitive situation, the bidding such matters for instance, as accurate knowledge of the volume and character of production, stocks, orders, the nature and trend of costs, prices and the like. His contention is that this possession of adequate knowledge of all facts bearing upon the competitive situation is the very essence of competition. Competition, considered as it is today, is most frequently by relatively ignorant competitors, by, according to Mr. Eddy, property crashing has competition at all. Ignorance gives competitors is largely responsible for the anarchy, frictionness, instability, uncertainness, destructiveness and wastefulness characteristic of industrial enterprise as it is conducted today, he adds.

Mr. Eddy's contention that "the essence of competition lies in the element of knowledge" and that "it is real, true and constructive in proportion to its openness and frankness, its freedom from secrecy" is not new doctrine in economic literature, although to the writing of the writer its true content has not been adequately emphasized in speech or writing. Economists have long taken cognizance of the fact that immeasurable elements of friction are ever present under actual competitive conditions to prevent the law of supply and demand from working itself out as it would if they were not present. Ignorance has been recognized as one of the determinants to an approach to a condition of free competition. In fact economists, in formulating the law of supply and demand (which, of course, lies at the basis of commercial competition) have made the explicit reservation that the law only holds if it is assumed that all interested parties are intelligent enough to know their own interest and are able and ready to act thereon. Obviously they will not be sensitive to their interests if they are not acquainted with all the conditions affecting the supply of and the demand for the particular commodity in which interest is centered.

Mr. Eddy does not make clear why he thinks that knowledge is the very essence of competition. The statement is undoubtedly very significant when proper interpretation is put upon it. Its importance (as the writer sees it) lies in the fact that a knowledge on the part of sellers and buyers of their own interest, implying as it does, a knowledge of all conditions that have bearing on the supply of and the demand for, a given commodity, together with the ability and willingness to act intelligently thereon, will result, according to the law of supply and demand, in similar exchanges taking place on similar terms, or to state it in terms of price, it will result in the making of an equilibrium price for the same unit of the same quality of the same commodity in the same market. This stability of market conditions which finds expression in a single price will cease only under the conditions named. It is stating it only in theory. But such stability can presumably be approximated by putting forth systematic efforts looking to and the eradication of sources of friction. Undoubtedly one of the most serious sources of friction is due to well-informed buyers lacking adequate knowledge—that is, knowledge so systematized as to make clear just what business policies the competitive situation demands.

The nearest approximation in actual life to a stability of conditions such as is attainable theoretically seems to have been realized

in the case of those commodities which have their market made on the exchanges. The reason undoubtedly is that the machinery of these exchanges, be they stock, bond, wheat, coffee, cotton or any other kind of exchanges, puts at the disposal of buyers and sellers an unusual amount of systematized information having a bearing oncompetitive conditions. The higgling between buyers and sellers, based as it is on a general knowledge of substantially all facts that have a bearing on competitive conditions, results in prices being named which vary very little from each other for given units of a given commodity of a given quality on a given exchange at a given moment of time. One only has to note the general confusion among buyers and sellers, manifesting itself in wide "spreads" of prices, that occurs in consequence of a temporary cessation of this exchange machinery, to know the importance of putting buyers and sellers in a position where they can know substantially all the facts of competition as well as act thereon. The open price plan is designed to accomplish for manufacturers what the exchanges achieve for their members.

It is a matter of common observation that there is considerable variation in the price prevailing for commodities in those cases where their market is not made on an organized exchange. This seems to be particularly true of manufactured commodities. It is a fair assumption that the "spread" in prices apparent in many if not most lines of manufactured commodities is to a considerable degree the result of buyers and sellers possessing an inadequate knowledge of market conditions. Unquestionably there are many conditions which tend to make similar commodities sell at different prices even though buyers and sellers are thoroughly acquainted with all essential facts pertaining to market conditions. This is undeniable, but doubtless the "spread" in prices will be less (whereby a closer approximation to ideal conditions of competition is achieved) when buyers and sellers are well informed than when they are not.

The open price movement has developed in response to the desire of business men to provide themselves with machinery for ascertaining the character of the forces of competition active in their respective fields of industry. Mr. Eddy asserts that his open price plan will tend to bring about a condition of true competition in the industries adopting it. What are the merits of this contention? Theoretically, at least, it would seem essential that any system devised for the purpose of securing more intelligence in competition should be sufficiently comprehensive to take in buyers as well as sellers. The ideal kind of competition contemplates a situation wherein all parties are intelligent enough respecting the character of competitive forces to be able to act in their own interests. However, if one group of bargainers is in possession of the salient facts of competition, but the other is not, it is safe to assume that the one will have an undue advantage over the other. In other words true competition will not prevail. Both the plan of organization of open price associations and Mr. Eddy's own statements point to the conclusion that open price work is intended to benefit the seller (particularly the manufacturer) primarily. He states that "true competition exists only where there are two or more competitors competing under condition that enable each to know and fairly judge what the others are doing." The term "competitors" may be applied to buyers who are in competition with each other in the purchase of goods, but looking at the statement in its context it becomes clear that Mr. Eddy uses the term in its commonly accepted meaning denoting sellers in competition with each other for the custom of the buyer. The plan itself is devised entirely from the point of view of the seller. In fact one of the principal inducements for trying out the plan, as Mr. Eddy states, is to prevent buyers from misrepresenting prices that are being currently quoted. He also suggests

in the case of those commodities which have their market made on the exchanges. The reason unquestionably is that the machinery of these exchanges, be they stock, bond, wheat, coffee, cotton or any other kind of exchanges, puts at the disposal of buyers and sellers an unusual amount of systematized information having a bearing on competitive conditions. The bidding between buyers and sellers, based on it is on a general knowledge of substantially all facts that have a bearing on competitive conditions, results in prices being based upon very very little from each other for given units of a given commodity of a given quality on a given exchange at a given moment of time. One duty has to note the general conformity among buyers and sellers manifesting itself in what "appears" of prices, that occurs in spite of a temporary cessation of this exchange machinery, to know the importance of putting buyers and sellers in a position where they can know substantially all the facts of competition as well as each therein. The open price plan is designed to accomplish for manufacturers what the exchanges achieve for their members.

It is a matter of common observation that there is considerable variation in the price prevailing for commodities in these cases where their market is not made on an organized exchange. This seems to be particularly true of manufactured commodities. It is a fair assumption that the "spread" in prices appears in many if not most lines of manufactured commodities is to a considerable degree the result of buyers and sellers possessing an inadequate knowledge of market conditions. Undoubtedly there are many conditions which tend to make similar commodities sell at different prices even though buyers and sellers are thoroughly acquainted with all essential facts pertaining to market conditions. This is undeniable, but doubtless the "zero d" in prices will be less (whereby a closer approximation to ideal conditions of competition is achieved) when buyers and sellers are well informed than when they are not.

The open price movement has developed in its core to the desire of business men to provide themselves with machinery for ascertaining the character of the forces of competition active in their respective fields of industry. Mr. Eddy asserts that his open price plan will tend to bring about a condition of true competition in the industries adopting it. What are the merits of this contention? Theoretically, at least, it would seem essential that any system devised for the purpose of securing more intelligence in competition should be sufficiently comprehensive to take in buyers as well as sellers. The ideal kind of competition contemplates a situation wherein all parties are intelligent enough respecting the character of competitive forces to be able to act in their own interests. However, if one group of interests is in possession of the salient facts of competition, but the other is not, it is safe to assume that the one will have an undue advantage over the other. In other words true competition will not prevail. Both the plan of organization of open price associations and Mr. Eddy's own statements point to the conclusion that open price work is intended to benefit the seller (particularly the manufacturer) primarily. He states that "true competition exists only where there are two or more competitors competing under conditions that enable each to know and fairly judge what the others are doing." The term "competitors" may be applied to buyers who are in competition with each other in the purchase of goods, but looking at the statement in its context it becomes clear that Mr. Eddy uses the term in its commonly accepted meaning denoting sellers in competition with each other for the custom of the buyer. The plan itself is devised entirely from the point of view of the seller. In fact one of the principal inducements for trying

that the plan will put buyer and seller more nearly "on a footing of equality." An outline of the steps that should be taken by the manufacturer in organizing an open price association is given. The buyer has no part to play in the organization. Buyers, to be sure, are to be permitted to attend meetings, but nothing is said about permitting them to have a part in the reporting system. The suggestion is made that purchasers might organize their own reporting system, but there is no intimation of how this could be accomplished. Obviously the trade statistics that they could obtain for themselves would be very limited in scope. They could compare prices paid for purchases, but they could not obtain statistics pertaining to such vital matters as amount and character of production, size, character and location of stocks of goods, etc. Those statistics could be obtained only with the cooperation of producers themselves. As a group, buyers, themselves, seem distrustful of the plan. The secretary of the National Association of Purchasing Agents writes as follows:

I am reasonably confident that there are no associations of purchasing agents engaging in any way in open price work. On the whole the viewpoint of purchasing agents is opposed to such association activities. The real function of the open price association, as we see it, is to permit producers to charge for their commodities not on the basis of their production costs or real competition values, but on a basis of all that the market will stand. Naturally, purchasing agents cannot be expected to sympathize with this viewpoint.

It is plain that the machinery of the open price plan does not put all the facts of competition before both buyer and seller in the impartial way in which it is done, for example, on the various commodity exchanges. As long as all parties concerned are not in possession of all facts relating to the competitive market, exchanges cannot be made on the terms contemplated by the law of supply and demand. Mr. Eddy's plan, then, failing as it does to provide a system whereby both buyers and sellers may be put in possession of all necessary information to make them intelligent bargainers, cannot be regarded as a complete solution to the problem of securing full and free competition in the transaction of business. Although the plan does not give promise of achieving what Mr. Eddy presented it would do, his achievement is noteworthy in that through the publicity he gave his theory and his plan, business men are coming to realize the importance and the practicability of devising machinery calculated to put them in possession of statistics needful to a proper regulation of price and production policy.

There is much speculation as to just what effect the operation of open price associations is likely to have on prices. What the actual effect has been it is impossible to say. The open price movement is but in its infancy; the fund of data based upon observation and experience is therefore likely to be inconclusive. The data are also difficult of access. In making a study of this kind it is thought that the method of approach should be, first, to compare prices obtained by members of open price associations with those received by competitors who are not members; second, to compare the prices received by the various members themselves. The object in the first case would be to determine if all members are getting the same price as non-members, or higher or lower prices, and in the second case to determine if periodic fluctuations in members' prices are more pronounced or less so than those of non-members, thus showing to what extent, if at all, prices tend to become uniform. The commodities involved would have

to be of identical kind. The investigation should cover a period of years. It should also be established that the non-members whose prices are used have had no access to the information pooled by members. Information bearing on prices received by members could most conveniently be obtained from the compiled reports of sales issued at periodic intervals to the membership by the central office of the association under study. To get accurate price data pertaining to outside competitors it would seem necessary to go to the records of the non-members themselves. No doubt it would be very difficult to obtain adequate data from a sufficient number of competitors to make these data representative. Probably few non-members could be found who have preserved records of sales for several years.

The court record in the case of U. S. vs. American Column and Lumber Co. involving the legality of the open price activities of the American Hardwood Manufacturers' Association, has thus far offered the only considerable contribution of price data available for study. In this case the defendants introduced several charts indicating prices received during the year 1919 for different kinds of hardwood by competitors who were not members of this association. In addition they introduced copies of all sales reports compiled and disseminated by the manager of statistics during this year. This was done in order that comparisons might be made between prices charged by members and those charged by non-members, the contention of the defendants being that such comparison would reveal that members were neither maintaining fixed prices nor obtaining prices any higher thanthose received by outside competitors. In studying these data and other sales data furnished him by this association, the writer found difficulty in extracting price data from reports of members' sales which were comparable to the data contained in charts showing prices received by non-members. The reason for this difficulty was that kinds, grades and thicknesses of lumber did not correspond. Only in the case of one outside competitor was it found possible to make a direct comparison of prices received by him with an average of the prices received by members. The comparison disclosed that the average prices received by members of the association for the year 1919 were no higher than those received by this particular non-member. A comparison of the average weekly prices received by three leading members of the association for the period from July 26 to December 27 of the year 1919 revealed that prices received by each of these manufacturers varied widely from time to time. The inference deducible from these comparisons would seem to be that open price work in the case of this particular association did not enable members to exact higher prices as a group than outside competitors were able to exact, nor did their activities result in price uniformity. In truth the data are too meagre to be conclusive on these points. In justice to the association, it should be added, however, that several purchasers of hardwood lumber signed affidavits to the effect that the prices paid by them to different members were neither uniform nor were they any higher than those paid to non-members.

In this connection it must be pointed out, however, that the price data taken from the association reports of sales cannot properly be used as a basis for determining the effect of open price activity on prices, because only to a very small extent did members use the sales reports issued in 1919 as a guide to the trend of the market, for by the time they were received from the manager of statistics (a week or two subsequent to the time when the sales listed were made) current market prices had advanced so far ahead of those listed on sales reports, market prices had advanced so far ahead of those listed on sales reports, that the latter, if they had been taken as a guide,

would in a great many instances have resulted insales at prices below the current rate.

It is significant that the small manufacturers apparently derived benefit from even these tardy sales reports. As previously stated, the prices listed on the sales reports were below the best market prices then prevailing, yet they were higher, apparently, than the ones these small manufacturers had been accustomed to receive prior to their entry into the association. Of the numerous letters received by the manager of statistics in commendation of the open price plan, all of those which pointed to the fact that the plan had enabled members to get higher prices were from small manufacturers. An unprecedented demand, accompanied by a shortage of supply, resulted in such a rapid advance in prices that the sales reporting system proved unequal to the task of keeping members properly apprized of the latest price developments. Obviously, then, the study made by the writer reveals nothing of importance respecting the influence exerted by the open price system on prices except inso far as the group of small manufacturers is concerned.

In the absence of adequate data one is tempted to indulge in speculation as to the probable effect of open price activity on prices. It has been argued above that a knowledge on the part of buyers and sellers of their own interest, implying a knowledge of all conditions that might have a bearing on the supply of and the demand for a given unit of commodity, together with the ability and willingness to act intelligently thereon, would result in similar exchanges taking place on similar terms. Jevons expresses the same thought when he says that "in the same market, at any one moment there cannot be two prices for the same kind of article." The concept here conveyed is undoubtedly at the basis (consciously or unconsciously) of the arguments of those who contend that open price work enhances competition and stabilizes prices.

If all the factors in operation in the case of open price activity are identical with those which express themselves through the operation of the law of supply and demand, it seemareasonable to conclude that open price work would lead to exchanges taking place on similar terms, with uniform rates emerging as a matter of course. To be sure it is conceivable that price uniformity can emerge through association work, despite differences in the factors at work, but it is not thought that such uniformity will ensue as a result of sellers acting independently of each other in their capacity of bargainers, but rather that it will come as a result, not necessarily of direct agreement, but of the power of suggestion, perhaps, conveyed to members by precept or example emanating from leaders in the industry. It is possible to conceive of price uniformity being achieved even without premeditation, if members form the habit, for instance, of guiding their price policy by that of one or two of the outstanding leaders in the industry. In fact the consummation of such a result may be facilitated by the every ignorance of buyers. Lacking the power that comes with knowledge they are likely to look upon the competitive situation which confronts them as being unchangeable, and may accept such prices as are quoted them out of a spirit of helplessness born of the feeling that they powerless to do otherwise.

It has been argued above that the seller, through his mem in an open price association, enjoys an advantage over the b consequence of his superior knowledge of market conditions

probable thatt
situation, of c
tion: To what e
to utilize the th
of their superior
The task involved
undoubtedly wrapped
not impossible, of
selves are of suffic
of practice members
to utilize their sup
prices upon the buyer

Influences at wo
work on prices can be
in the operation of t
utilize the informatio
third, the limited spho
tions.

Defects in the oper
selves chiefly in the fo
tion of the articles abou
price comparisons more or
character of information
comparisons are to a cons
price information is exch
Differences in size, shap
bound to express themselve
differences persist, the r
that is needed if inter
the course of prices.
prices comparable is di

Conversation with
veals that interchange o
because members turn in in
the compiled reports issue
ship too late to be of muc
ditions. If for any of the
reliability of the sources
likely to act independently
prices are influenced less

Failure of members to
through the operation of t
a deliberate disregard of
pret it, or to inability t
secretary writes that mem
inquiring what ruling pri
sales reports containing
desks at the very time w
Many members, no doubt,
cause they are unwillin
proper interpretation.
understand the reports
utilized because member
ports of production and
point to the desirabilit

period. But the necessity of meeting heavy overhead expenses may force the unfortunate producer to continue operations on the old scale. Assuming that these reports should point to a probable future glut in the market, the normal tendency would be for each member to put the brakes on production, and obversely, if they should point to a probable future scarcity, production would be accelerated. In either case prices would tend to run on a more even keel in consequence of this regulation of production. But obviously no such result will follow unless members are free to react in the manner indicated. Failure to utilize information for one reason or another is therefore another factor operating to prevent open price work from influencing the course of prices.

There is reason to believe that because of the serious obstacles operating to prevent the spread of open price activity, particularly in the larger industries where competitors are likely to be numerous, open price associations do not find themselves in positions of control in their respective industries. The lumber industry, perhaps, offers the most conspicuous example of the attempt to secure cooperation among a large body of competitors under an open price plan. Even in the most successful association of the many in the lumber industry doing open price work, the American Hardwood Manufacturers' Association, it was found well-nigh impossible to secure sufficient cooperation among competitors to make the plan reasonably successful. Early in the year 1919, after an existence of about two years as a consolidation of two associations that had existed for several years previous, the membership had nearly reached the four hundred mark. This membership controlled but twenty-eight per cent of the total hardwood production of the industry. There were some 12,000 to 15,000 independent hardwood sawmills altogether. It is apparent that such statistics of stocks, production, etc., as were reported by members would not give totals which could be considered representative of the hardwood industry except in a very crude, inaccurate way. Of course, statistics are not available to show what percentage of production is under the domination of open price associations in the other industries where they prevail, but it is believed that their history in the larger industries, at any rate, is not unlike that obtaining in the lumber industry. The cooperation required is of a most intimate and unprecedented kind. Even the most intelligent business men find it difficult to grasp the spirit of cooperation which obliges them to lay bare before competitors statistics intimately related to their own businesses. Distrustful and suspicious of the motives of competitors as many of them are, they are not easily induced to take membership in associations of this character. The expense of membership may deter some from joining. Others may be deterred by a fear of arousing the hostility of customers who may view their open price activities with suspicion. Still others demur because they fear government prosecution or because they believe the open price system to be an unlawful price-fixing scheme.

If the sphere of control is limited by inadequate membership, the influence exerted on price movements would seem to be of little effect. In addition to the power exerted over prices by those who are not association members there is also the presence of indirect and potential competition to contend with. By reason of the danger of competition from substitutes and new capital, prices are likely to be confined to narrower limits of variation than would otherwise be the case.

If the sphere of control is insufficient to permit the educating influence of the association to be felt by competitors in whom are represented a substantial proportion of the total productive capacity of the industry, it appears more than probable that the competitors outside the sphere of this influence will be as instrumental in determining the price situation as association members--or even more so, perhaps. Competitors outside the ranks of membership are presumably less well informed about conditions affecting the market than are members. As a class their knowledge of the costs of doing business is presumably less thorough. Lacking information bearing on the character of the competitive situation, and being relatively ignorant of costs, it is probable that in their anxiety to make sales they will permit themselves to quote lower prices than they would if they were acquainted with all the facts. The disposition of many buyers to take advantage of the ignorance of sellers, inducing them through misrepresentation to quote lower prices than competitive conditions warrant, gives added weight to this prediction. Knowledge brings power. Lacking knowledge, it becomes almost a certainty that competitors outside the ranks of membership in an open price association will obtain lower prices than those inside. If low-price competitors are present in an industry in sufficient numbers they are likely to exert the determining influence in the establishment of market rates, for customers will generally give their custom to those who make the best prices, assuming that all other conditions entering into the situation are equal. The fact that all other conditions are not on a par of equality probabl accounts in some degree for the fact that prices which are recognized as being typical of the market are somewhat higher than those secured by the lowest-price competitors. For one thing, the lowest-price competitors may lack the necessary productive capacity to handle a large volume of orders; then too, their product may not be up to standard, or they may be unreliable in some other way. Of course the low-price competitors who sell below their cost of production through ignorance of costs will not in the long run survive; but it is not improbable that in many industries a new crop of producers equally as ignorant of costs and market conditions appear in their stead, thus tending to continue the depressive influence on prices that makes competition so difficult for members of the association in the industry or for other well-informed competitors who have a due regard for their costs and market conditions. These low prices expose members to the danger of losing some of their custom. If the productive capacity represented by these outside comptitors is sufficiently great, members may be compelled to place their rates in line with theirs in order to insure for themselves the share of business to which they have been accustomed.

Many instances will be found where individual members have succeeded in getting better prices as a result of participation in open price work. That does not mean, however, that the association (assuming that it does not have a controlling influence in the industry) has succeeded in raising prices in the industry as a whole, nor is it probable that in the instances where members have been able to secure better prices, these prices have been any higher than the ones current among outside competitors.

Summing up the points that have been made regarding the probable effect of open price work on prices we have the following:

1. Although theoretically members of open price associations can take advantage of their superior knowledge of market conditions to

exact higher prices from the buyer than would be possible if the latter were equally well informed or open price work were non-existent, yet in practice it is thought that in most industries of the larger type, at least, buyers suffer no such disadvantage, for the reasons, first, that the effectiveness of open price associations is compromised by defections in the open price system itself and by slackness in its manner of use by members; second, that the sphere of influence of open price educational activity is probably in most cases too limited to overcome the influence exerted on prices by (1) outside competitors, (2) potential competition from substitutes or new capital.

2. Although open price work probably has not operated to raise the general run of market prices extant in the industry as a whole, in certain individual instances better prices have been secured, these inuring in the main to the smaller producers, who, prior to their entry into open price work, are seldom able to exact prices recognized to be the current market rates, but find themselves more able to do so in consequence of the better acquaintance with market conditions derived from membership in the open price plan.

3. Rates are not likely to attain any degree of uniformity (except in so far as the higher prices secured by low-price competitors through participation in open price work contribute toward such uniformity) unless members exercise a controlling influence over the industry, in which case uniformity may be attained, not through free competition ensuing from a competitive situation in which both buyers and sellers are conscious of all influences affecting demand and supply and are therefore awake to their interests, as is held in contemplation by the law of supply and demand, but through the very ignorance of buyers, resulting in docile acceptance of a rate made more or less uniform, if not by direct agreement among members, perchance by the power of suggestion, emanating from leaders in the form of precept or example.

The weakness of open price activity from the point of view of the welfare of consuming interests is attributable to the fact that buyers are not equally fortified with sellers in the competitive struggle; they lack access to the channels of businessinformation enjoyed by their opponents. In practice the peril would not seem to be great unless an open price association enjoys a controlling influence in the industry with which it is identified. It is under such a circumstance that attempts to enhance prices directly, or indirectly through curtailment of production, carry the best prospects for successful accomplishment. Success or failure in enhancing prices probably would then hinge mainly upon the effectiveness of the restraining influence exerted by potential and indirect competition. It is conceivable that a considerable margin of increased profit might be obtained, if not permanently, at least for extended periods of time, before new capital would be attracted into the industry or a resort made to the use of substitutes. These enhanced prices might ensue solely as the result of the advantage enjoyed by members over buyers in the way of superior knowledge of market conditions, no resort to collusion being made. However the temptation to pool knowledge in such a way as to accomplish price enhancement by means of collusion would be exceedingly strong, as is admitted by the staunchest defenders of the open price plan, the inducement being especially great by reason of the fact that members would be aware of their controlling influence in the industry. Collusion might be achieved in a manner so subtle as to defy all detection by officers of the law.

It may be assumed that the end and aim of all open price associations is to achieve control over as large a percentage of the industry in which interest is centered as conditions will permit, if for no other reason than that adequate forecasting of business conditions hinges on the possibility of accumulating data from a sufficient number of competitors to be representative of the industry as a whole. If this is the logical end of the open price movement, what may be said respecting the proper destiny of open price work? One consideration seems paramount: irrespective of whether it is or is not found feasible to permit associations of business men to engage in open price work, the work itself must not be abandoned. The information side of business is rapidly becoming an exact science. The trend of the times is in the direction of greater insistence upon the accumulation of precise and accurate business information of a statistical character. A mere statement that business is good or business is dull will not for long be accepted as sufficient criteria of the trend of business conditions. Manufacturers as a class will not be long in insisting on having at their finger tips actual figures for their industry, showing, for instance, the increase or decrease in production from a known standard; the increase or decrease in unfilled orders, and the increase or decrease in raw materials and finished product on hand--all this in order that they may have an index to the volume of trade. Among other things manufacturers are coming to learn that in order to avoid to the greatest practicable extent the periodic disturbances to production that come from unrestrained overexpansion, now recognized to be largely due to a general lack of broad insight into business conditions, they must possess themselves of information of this statistical character.

It behooves government officials to come to a full realization of the fact that it is a mistaken public policy, and is also utterly futile, for them to attempt the task of forcing business men to compete in ignorance and secrecy. Our hope for improving competitive conditions lies, not inforcing business men to conduct their businesses like moles, but in giving them all the enlightenment possible as to the factors that influence the competitive situation. The open price movement has no doubt sprung into existence in response to the growing desire of business men to govern their business operations intelligently in the light of existing business conditions. They have tried to do for themselves what the government does in a small way for the farmers. At great expense to itself, the government issues crop reports to the farmers for the express purpose of enabling them to market their products more intelligently. Since it is clear that an approach to more wholesome competitive conditions must come through the wider dissemination of more exact knowledge of the factors influencing business conditions, it seems ill advised to force associations whose efforts are dedicated to these purposes to cease their activity on the ground that prices happen to be increased thereby - unless the government is prepared to assume the responsibility for seeing that open price work of equally efficient character is carried on by some less objectionable agency, either private or public. To put a ban upon open price activities without offering something in their stead would tend to discourage a valuable incentive directed toward the achievement of greater efficiency in bargaining. The greater the development of efficiency in bargaining, the nearer is the approach of actual competitive conditions to ideal competitive conditions.

If future observation and experience point to the conclusion that members of open price associations are securing too liberal returns on their investment in business education, at the expense of the ignorance of buyers, the proper solution would seem to lie, not necessarily in prohibiting them from engaging in open price activity, but in widening the sphere of open price influence so that not only members of open price associations may receive the benefit of it, but also all others who have a direct interest in the competitive situation. With all bargainers equally well equipped with scientific business information, no group of men associated for the purpose of disseminating information of this character among its membership would be in a position of dominance in any industry, for they no longer would possess a monopoly of such information. If the necessary machinery could be constructed for putting both buyers and sellers in every industry in possession of all information necessary to make them intelligent bargainers, one of the most serious causes of friction of the many that now prevent actual competitive conditions from approaching ideal competitive conditions would tend to be eliminated. Whether the function of collecting, compiling and disseminating business statistics should be left in the hands of associations of business men in each of the industries, without, however, confining membership to one bargaining group as is now the case in the manufacturing field, but extending it to include the group of buyers, or whether this function should be turned over to the government to administer, is a question that will not be discussed here. The perplexing and complex character of the issues here involved are such as to call for independent treatment.

Milton N. Nelson

University of Illinois

Reading # 17.

THE GARY DINNER SYSTEM: AN EXPERIMENT IN COOPERATIVE PRICE STABILIZATION

Maurice H. Robinson, University of Illinois.

While the crisis of 1907 first manifested itself in Wall Street circles, it became evident at once that unless effective measures were taken to prevent its spread the demoralization in the security markets would extend to the various industries, and especially to the iron and steel business, the barometer of trade and commerce. Immediately after the first shock of the panic had passed, the officers and directors of the United States Steel Corporation were importuned to exert their influence in stabilizing prices, even to use the funds of the company to assist a certain firm that found itself too heavily loaded with unsaleable securities. Passing over the purchase of the Tennessee Coal and Iron Company, we may center our attention upon the efforts undertaken by Mr. Gary, chairman of the board of directors of the Steel Corporation, to prevent a general demoralization of prices in the iron and steel industry and to devise means by which this end might be achieved. While a stickler for legal methods, Mr. Gary was a thorough believer in cooperating with his competitors as well as with his customers. It is not strange, therefore, that when confronted with the dangers of a runaway steel market, at a time when the various iron and steel associations had been virtually abandoned, Mr. Gary should have invited the leading representatives of the industry to a dinner to consider the situation and take such measures as might be deemed necessary and proper to prevent the injurious effects that normally result from a demoralized market.

The first of the so-called Gary dinners was held in New York on November 20, 1907. At this meeting fifty-one guests were present, representing approximately 90 per cent of the iron and steel trade of the country. The object of this meeting was, in the words of its founder, "to prevent the demoralization of business, to maintain as far as practicable the stability of business and to prevent, if I could, not by agreement, but by exhortation, the wide and sudden fluctuations of prices which would be injurious to everyone interested in the business of the iron and steel manufacturers."

After Mr. Gary's address "depicting conditions" and "proposing cooperation," the guests expressed their opinion individually in regard to the market; whether or not prices were fair and reasonable; and generally in regard to the financial outlook; especially as to whether or not and to what extent the condition of the money market, of finance, trade, and industry, was likely to affect the demand for the products of the iron and steel industry.

Whether deliberately so planned or not, the Gary dinner system, as it actually developed, proceeded along two lines quite distinct from each other in method, although having a common purpose--that of maintaining or stabilizing prices in the face of a badly demoralized market.

The general meetings, the dinners, the luncheons, etc., which were followed by an address by Mr. Gary and a round-table discussion by the leading spirits in the industry, were designed to bring the men into "friendly contact," to dispel that feeling of suspicion and distrust by which the industry was formerly characterized in order "to prevent destructive warfare--bitter, fierce, tricky, de-

structive warfare," and thus to insure "fair and decent" treatment of their competitors by all of the companies engaged in the manufacture of steel and iron. Confidence, cooperation, and common decency were to take the place of distrust, destructive competition, and the old-time trickery of the trade. By these means stable prices could be maintained, the "law of the survival of the fittest" could be rendered inoperative, and the element of uncertainty, "the prime factor in causing disorganization," could be removed.

But the leaders of the steel industry were far too experienced in the ways of the business world to rest their case on exhortations, appeals to sentiment, and the friendly interchange of views. Cooperation, although founded upon mutual confidence and fostered by exhortations and sentimental appeals, is, nevertheless, dependent upon an effective organization; and, in recognition of this principle, Mr. Gary and his guests, after the discussion regarding conditions and prices, finally voted to appoint a general committee of five, with power to add to their number from time to time, and, as it appeared later, clothed with authority to select a series of sub-committees to represent the important branches of the iron and steel industry.

Within approximately a month the sub-committees were announced in the trade papers, and immediately thereafter began their work. While the general committee was intended to represent the general interests of the iron and steel industry, the sub-committees were designed to carry the general policies formulated at the first Gary dinner into operation. Originally eight sub-committees were appointed, representing the following specific lines of products: ore and pig iron, rails, and billets, structural materials, plates, steel bars, pipes and tubular goods, sheets and plates, wire products. As the situation developed, the personnel of the several committees was slightly changed and an entirely new committee added, representing billets and steel bars.

The sub-committees as finally constituted thus not only represented the important products of the industry but, what is of greater significance in this connection, were, considered individually, the virtual successors of the so-called statistical associations, and through them of the pools and combinations of the period beginning, generally speaking, in the early nineties and ending with the withdrawal of the subsidiaries of the Steel Corporation from the various associations late in 1904. There was, however, one important difference that should not be overlooked. Never before had there existed any central association or general committee representing the entire industry. The Gary dinner system thus not only resuscitated the partially decadent association, but infused new life and vigor into their activities by furnishing new ideals of cooperative action and a central organ to coordinate the work and stimulate the several sub-committees whenever the occasion demanded.

The sub-committees met at irregular intervals, determined partly by the conditions in the branch of the industry which each represented and partly by the zeal of the individual chairman. Some of the committees met as often as once a month; others seem to have met only three or four times each year. Sometimes the meetings were participated in by the members of the committee only, at other timesa considerable delegation from companies not represented on the committee would be present and take part in the discussions. At all of the committee meetings the procedure was fairly uniform

in character. The chairman, generally a representative of one of the larger companies and always a participant in the Gary dinners, would lead the discussion, calling attention to the general condition of the market, to the proceedings at the latest Gary dinner, if one had been held in the interim, and to the activity in the industry as represented by the various mills. At more general discussions, each person present would usually give full information in regard to the orders on his books and the prices he had been receiving. All of this discussion was preliminary to the main object of the meeting, namely, an "understanding" on the prices for the immediate future. Generally the larger companies, for example the Illinois, the Carnegie, the American Sheet and Tin Plate Company, would make a first announcement as to future prices and express the hope that the others would adopt the same general policy. Sometimes an understanding would be reached with alacrity; more often it would appear, from the testimony of participants, that differences of opinion would arise, some holding out for the maintenance of prices with a falling market or for a greater increase or a deeper cut than the majority thought wise. Notwithstanding such differences of opinion, the committees seem always to have continued the session until an understanding was reached acceptable for the time to the majority. Immediately after the adjournment of the committee meetings an announcement of the action taken would be made and, generally speaking, such announcement would appear in the trade journals.

The understandings, thus reached after the facts in regard to business conditions and to the business of each of the companies in the different lines had been ascertained and distributed so that each company could keep thoroughly informed as to what the others were doing, although not agreements in the ordinary sense in which that word is used, were generally considered to be morally binding upon all parties to them. The moral obligation, however, was assumed subject to conditions. First, any party to the understanding was expected to give due notice to all the other parties before departing from the schedule of prices which had been adopted at the previous meeting. This was regarded as a matter of "common business decency," and anyone failing to observe this condition was likely to be called to account at the next meeting. Second, the understanding, being based upon the market conditions, was subject to revision whenver those conditions changed. While the understanding was subject to abrogation by sending notice to all the competitors, it seems to have been regarded as essential to the harmonious working of the system to call for a meeting of the committee and discuss the situation with a view of reaching a new understanding in "the light of the changed conditions." As a matter of fact, the schedule of prices established as a result of the various committee meetings appears to have been generally followed for the period immediately following the announcement. In the case of every commodity except rails, the understanding was disregarded sooner or later, and when the cutting of prices became of sufficient dimensions to merit attention a meeting of the committee was called, the situation reviewed, a new understanding reached, and a new schedule of prices announced. The frequency of meetings in the various lines was thus an indication of the relative difficulty experienced in maintaining prices.

At such meetings the procedure varied. Sometimes the individual who was accused of disregarding the schedule would be openly charged with violation of the understanding. In some cases the accused would admit the charge and attempt to justify his action by stating that he had been forced to do so on account of repeated price-cutting by some of his competitors. Then an investigation would follow and a readjustment on the basis of the findings would be reached. More often the accused would reply that a mistake had been made, sometimes in a freight rate, sometimes in the terms and conditions, sometimes in the price. The offender would then state that such mistakes would be prevented in the future, and the meeting would then reaffirm prices and adjourn. Sometimes the accusation would be general in its nature. Prices were being cut in such and such a district. Representatives from the districts where the cutting was prevalent would then give their views on the situation and, after discussion, the meeting would arrive at a decision, either to maintain prices or to reduce them to a point where the incentive to cut would be less strong. In either case a new understanding would be reached and the members of the committee would individually announce that they would observe its terms, subject, of course, to the conditions above specified. Month by month the process would continue; an understanding, price cutting, a meeting of the committee, a new understanding, a new announcement, and so on, in a constantly recurring and never-ending series.

The Gary system of cooperation, including dinners and committee meetings, continued in active operation without any break until February 18, 1909. During that period prices of the more important commercial products of the iron and steel industry, including billets beams, plates, bars, sheets, wire, wire nails and rails, were maintained on a level substantially equivalent to that which prevailed during the year 1906 and the first three-quarters of the year 1907.

From November 20, 1907, to May 31, 1908, prices of the several commodities mentioned above were held at the high level established during the boom market of November and December, 1906. The Iron Trade Review, in the issue of December 12, 1907, calls attention to this remarkable phenomenon--"an utter absence of price competition at a time when the amount of new business offered is but a small portion of the previous normal, and when the actual production is less than one-half the rate of two months ago." It further states that "the trade accepts as one of the important causes of this situation the fact that there was a meeting of billet producers in Pittsburg, October 30, and a dinner in the Waldorf-Astoria, New York, on November 20, those who attended being guests of Chairman Gary of the United States Steel Corporation." During this same period the price of pig iron, which the committee on ore and pig iron seems to have been unable or unwilling to control, sagged gradually from the new high level reached early in 1907 to a low level approximately the same as that of 1905. The "spread" between the raw materials and the finished products was thus continually increasing, even in the face of a market badly in need of stimulation. Under the leadership of the new steel kings, the policy adopted and consistently followed by the Carnegie Company in the period following the panic of 1893 had been abandoned, if not forgotten. Referring to the question of reducing prices in order to obtain sufficient tonnage "to keep our mills running at full speed," Mr. Carnegie wrote to the directors as follows: "In former depressions we announced our policy, viz., take all the orders going and

run full. . . even with rails it may be our best policy to meet low prices and run full. . . structural steel, probably one-half of all the steel made at tolerable prices, would be better than a large amount at lower prices, and it would be a pity to disturb an agreement that has worked so satisfactorily. In plates and all other things except these, I can see nothing for it but the old policy, take the orders." "My opinion is that whatever temporary advantages might accrue from percentages which would restrict our running, our property will be worth far more years hence by deciding that come what may we shall run full as long as there are orders in the market. You know we can run full and have a margin of profit.

Even before the Gary dinners, the steel makers, either by concerted action or as a result of the "growing appreciation of the fact that the old methods of warfare, working reckless cutting of prices, benefited no one, whether producer, consumer, or workman," adopted a policy of restricting output and maintaining prices. Two reasons were given for this action: first, the fear of a runaway market should the policy of price cutting be permitted even as a temporary expedient; and second, the commendable desire to protect customers who had large stocks of goods on hand purchased under the regime of high prices which prevailed during the ten months immediately preceding the panic of 1907. At first there seems to have been no opposition to the policy adopted by the leaders. As soon as the surplus stocks in the hands of dealers had been reduced to normal proportions, an agitation was begun having for its object the stimulation of the demand by a reduction of prices. As early as January 20, 1908, Mr. Bope of the Carnegie Company expressed his doubts as to "whether it is the proper policy for the corporation to force the issue against all economic conditions." A week later he advised the directors that it might be possible to maintain prices and obtain business sufficient to utilize 40 to 50 per cent of the capacity. At the same meeting it was stated that the Carnegie Company was then "booking" about 30 per cent of the amount booked in the corresponding period of 1907. By April 30 price competition, especially in bars, was reported to be "knocking everything in the head." Early in May Mr. Bope undertook a personal investigation of the situation, attending the meetings of the local sales managers of the company throughout the country for the purpose of determining whether the surplus stocks in the hands of the jobbers had been sold and whether the time was not ripe for a reduction of prices. On his return he reported as follows: "I found the unanimous report was there are no stocks, neither of raw nor finished material, in the hands of the consumer or jobbers today, or indeed in our own warehouses. They are just about as bare as they can be. The people would like to replenish their stocks, but are not satisfied as to the future of prices. . . The general feeling reported by the salesmen who come in contact with the trade is that the object of maintaining prices having been accomplished, there should now be some reduction in steel products. . . Everything else has come down practically. . . The agricultural people are anxious to get busy again. . . but cannot afford to pay our prices. . . they do not ask for a heavy reduction. . . they want a reasonable cut. . . with assurances that they (prices) would not go below this point, claiming that this would create a feeling of confidence, which appears to be lacking at the present time."

It is evident from an examination of the evidence presented by the Government and by the Steel Corporation in the case of the United States v. the United States Steel Corporation, that the men

having charge of the sale of the steel products were unanimously in favor of a reduction of prices, while those connected with the finances of the several steel companies engaged in the cooperative movement were as unanimous in favor of price maintenance. Mr. Bope presented the case for a reduction of prices "very forcibly" the following week, and while the arguments were admitted to be reasonable the committee, for other reasons which seemed "good and sufficient" to themselves, decided to continue the policy of price maintenance.

Notwithstanding the unanimous opinion of the principal manufacturers of steel that prices should be maintained, price cutting became more and more prevalent, and the re-rollers were steadily increasing their business at the expense of the regular manufacturers It soon became evident that the cooperating manufacturers were unable to control the situation without a revision of the price schedule and, therefore, a meeting of the committees was arranged for early in June. As a result of this meeting, the prices of the principal steel products except rails were reduced from the level established late in 1906 to one substantially equivalent to that which prevailed during the latter part of 1905 and most of the year 1906. The reduction thus finally decided upon had the effect of limiting the field of the re-rollers, discouraging price cutting, and stimulating the demand. During the remainder of the year 1908, and even into January, 1909, the cooperative movement was generally supported by the manufacturers and prices were fairly well maintained. But early in February signs of a complete disruption of the Gary system began to appear, and on February 17 the finance committee and others appointed a special sub-committee on trade conditions, and as a result of the report of the sub-committee the Steel Corporation decided to withdraw from the cooperative movement inaugurated through its chief executive officer in 1907, and on February 19, at a general meeting of the leading steel manufacturers held under the auspices of the American Iron and Steel Institute, declared for an open market. Immediately following the declaration of February 19, prices were reduced generally from $2 to $4, and in certain cases $6 per ton and, although the "open market" was regarded with suspicion for a time, the orders began to come in and by the end of March the open market policy had completely vindicated itself by stimulating general business without at the same time demoralizing the iron and steel trade. With the declaration of the open market, the Gary system, properly speaking, came to an end.

As a result of the general reduction of prices following the declaration of the open market, the industry soon assumed a normal condition, and by September 1, 1909, the Carnegie Company had booked orders for pig iron in excess of its productive capacity and early in that month began to advance prices of all kinds of finished products except rails. Before the open market was declared by the Steel Corporation, the competitors of that company were booking a much larger share of the total tonnage than was possible under a competitive price schedule. Immediately after the cooperative movement was abrogated, the United States Steel Corporation began to regain its former position in the industry and within one month thereafter it was said to be setting a pace a little too fast for the other mills. By October 1 prices of the various commodities had been advanced to a level approximately the same as that maintained by the statistical association of 1906, and all the manufacturers, the United States Steel Corporation as well as the independents, were apparently ready for a resumption of the cooperative movement. As Mr. Gary, the chief executive officer of the Steel

Corporation, had taken the initiative in 1907 in proposing the policy of cooperation and again in 1909 in the declaration of the open market, it was evident to all parties that the call for a general meeting of the steel manufacturers would be received with better grace if it were cloaked under a summons less obvious than an invitation to another Gary dinner. As usual, the steel makers were equal to the emergency. It was proposed to present a loving cup to Mr. Gary in honor of his work as a peacemaker in the industry and thus open the way for a new era of harmony and cooperation. The event was arranged for October 15, 1909, and at the complimentary dinner the addresses, with the exception of those immediately connected with the presentation of the loving cup and the responses, were entirely occupied with restoring the principles of the cooperative movement and following such restoration a return to the methods and measures of the Gary dinner system.

The keynote of the evening was sounded by Mr. Willis H. King, vice-president of Jones & Laughlin, in an address on the subject, "The Old Order Giveth Place to the New." The old order was "an almost unbroken record of disappointment and disaster, of long credits and bad debts, of unreasonably high or unreasonably low prices, of destructive competition, of sales below costs, of bankruptcy for the many, of competence for the few. The new order was one of reasonable competition, of friendship in business, of high standards of honor, of stable prices, and of general prosperity in the whole industry." Mr. Drummond of the Agone Steel Company of Canada, speaking on "Basic Principles," credited Mr. Gary with having transformed the steel industry by dispelling the feeling of distrust that formerly pervaded it and establishing the new basic principle of "trust and good faith in one another." Mr. Schwab in making the presentation speech, emphasized the same idea by calling attention to the fact that while men had been honored for scientific attainments or for operative ability, this was the first time that the heads of all the leading concerns in the United States and Canada had assembled to do honor to a man who had merely introduced a new principle into the industry.

Mr. Gary, after acknowledging in appropriate language his appreciation of the honor thus given him, turned at once to the central theme of the evening, viz., the elimination of destructive competition and the substitution therefor of fair and friendly cooperation. In former days, he stated, while there was no actual breach of the law, while there was no recourse to force and violence, still the methods employed generally in the iron and steel trade were calculated to enforce the law of the survival of the fittest. Such a course, he asserted, was not for the best interests of all concerned, including the manufacturer, his workmen, his customers, and the general public. The panic of 1907 demonstrated the truth of this. On that occasion a financial giant arose and, turning his face toward the storm, with his keen perception piercing the clouds and discerning the sun of prosperity on the other side, invited his friends to join him in providing financial assistance to the weak and afflicted banks, at the same time he gave words of hope and cheer to the communities at large. This action on the part of Mr. Morgan was the result of his feeling of friendship for his acquaintances, his neighbors, his countrymen, and humanity in general. Inspired by his example, Mr. Gary continued, "you adopted a similar policy, you came together in the most friendly spirit, high minded, honest, frank and fair toward each other, and with a kind feeling for all who might be concerned in our action. You literally placed upon our table all evidence relating to your affairs, your methods,

your interests, your conduct, and your intentions. . . Never before in the history of the country did such a large body of men, with responsibilities so great, treat one another on a basis so generous, fair and high-toned." "For your action under such trying circumstances," he assured them, "you have been commended by leading bankers and financiers, and especially by your customers. The principles then applied so successfully must be extended. If they are good for us, they are equally good for our employees and the public. You have taken an advanced position, and you will not recede from it."

The event was ably planned and skillfully executed. It was followed by a general advance in prices, a resumption of conferences between representatives of the leading steel manufacturers, and a cessation of the complaints in regard to price cutting, unfair competition, and the like. But as in the case of the Gary dinner system the steel makers were far too shrewd and experienced to depend wholly upon appeals to sentiment, or incitations to a new code of business honor. The Gary dinner system had been established, inspire and directed by one man; now a permanent organization of the entire industry must be effected.

On September 11, 1908, Mr. Gary was the guest of honor at a complimentary dinner given by the governors of the Iron and Steel Institute of Great Britain. On that occasion, while preaching as usual the doctrines of cooperation, Mr. Gary closely observed the structure and operation of the organization through which the steel makers of Great Britain were associated. Soon after his return to America, the American Iron and Steel Institute was projected and early in 1909 it was fully organized and began its work. Mr. Gary was elected the first president, and Mr. J. T. McCleary was somewhat later appointed as secretary in charge of the general activities of the association.

The Institute was created to furnish a common meeting place for those responsible for the management of the various steel mills; a place where all kinds of questions bearing upon their business affairs might be freely and fully discussed; where ethical questions were to be considered as important as economic or scientific ones; where "the rights and duties of each member, so far as his conduct relating to this particular department of industry is concerned and within the limits of propriety, should always be matters for the deliberation of the whole membership of the Institute." During the latter part of 1909 and the early part of 1910 the Institute was in process of organization. It was intended to hold the first public or formal meeting in May, 1910, but the meeting was postponed to October of that year in order to secure the attendance of certain foreign manufacturers who were visiting the country at that time.

On this occasion Mr. Gary was the chief spokesman and, after outlining the purposes of the Institute as conceived by the charter members, directed attention to the theme which had occasioned the foundation of the Gary dinner system, viz., the maintenance of stable prices by means of the cooperative movement. After defending vigorously the policy of maintaining stable prices, he went on to state the means by which such a result may be achieved. These proposed means were: First, continued cooperation; second, frank and friendly intercourse; third, full disclosure of his business by each to the others; fourth, recognition by all of the

rights of each; fifth, a disposition to assist and benefit each other so far as practicable and proper; and sixth, conduct founded on the belief that healthy competition is wiser and better than destructive competition. Agreements to maintain prices, he affirmed, are not merely illegal, they are unnecessary. There is, however, no law to compel competition. Wherever competitors come into frequent and friendly intercourse, where they make full disclosures, where they notify each other of what they are doing, they will not act unjustly or dishonorably toward each other. This contention, he assured them, had been proved by experience. The cooperative movement is destined to extend, he continued, until it shall embrace within its domain not only domestic competition, but foreign competition as well, and even the governments of the Nations of the earth. It is to be the function of the Institute to act as the organized agent of the steel makers in extending the spirit of cooperation to our competitors, to our employes, and to our customers.

Notwithstanding the unanimous approval of the cooperative movement, as expressed at the first formal meeting of the American Iron and Steel Institute; notwithstanding the meeting of the committees, conferences, and conversations, the demand for steel and steel products continued to fall off, stocks continued to accumulate, and prices continued to decline, except in those lines that were under complete control, such as rails, bars, and plates. With pig iron accumulating, while the price was gradually falling, the situation grew more and more serious. Moreover, the arguments in the Standard Oil and tobacco cases were then being made, andthe attitude which the Supreme Court might take toward combinations, consolidations, and understandings was at that time a matter of the greatest uncertainty. In view of these circumstances, a special meeting of the American Iron and Steel Institute was called for January 11, 1911, for the purpose of considering the cause or causes of the hesitation in business and of determining upon the proper course to pursue in view of the conditions.

At this meeting there were eighty-nine men present, including the chief executive officers of every important steel producing plant in the United States. Of these, thirty were called upon to express their own individual opinion in regard to the situation, and without exception every speaker expressed the view that "any change in prices would be a calamity." All were in favor of the cooperative movement, of frequent meetings, of maintaining the situation, of standing together, and of waiting for improvement in conditions which was sure to come provided business was not unsettled by a reduction in prices. This program, it was thought, was not only defensible as a general proposition, but, according to the views of Mr. Gary, was entirely feasible. The leaders of the steel industry, he affirmed, were not only gentlemen, they were friends, and neighbors, having an affectionate regard for each other. Each of them had reached a position oso high in the industry that they were bound in honor to protect each other and, where one's honor was at stake, the position was more binding than any written or verbal contract.

As a direct result of the January meeting of the Institute, prices were fairly well maintained until May 24, when the Republic Iron and Steel Company gave notice that on and after that date it would make a reduction of $3 per ton on steel bars, its principal product. With a market already overstocked and prices maintained above the competitive level by concerted action, the step of the

Republic Company was sufficient to reestablish an open market not only for bars, but for all other steel products, except, of course, standard rails. The action of the Republic Iron and Steel Company was at once taken into consideration by the leaders of the cooperative movement, with the result that a luncheon was given by Mr. Gary at the Metropolitan Club in New York City on May 29. At this meeting Mr. Gary delivered an address, the principal object of which seems to have been to determine whether it was the opinion of the steel makers that "the time for cooperation had gone by or whether it should be suspended and each one should take care of himself, go his own way, doing his own business in his own way, when, where and how he pleased." The real question at issue was, he assured them, "whether or not you and your business can be entirely demoralized by the disposition or the action of one individual or a few individuals in the trade. While, according to Mr. Gary, he had no wish or intention to make any agreement, express or implied, contrary to the law, it was his opinion that it was highly important for the long future that the steel manufacturers continue their relations of friendship and open and frank expression with reference to what they were doing. His position never varied. He was always ready to give the names of customers, the prices charged, and any information concerning the business, the mills, the clients, or the company, so long as those seeking such information were willing to reciprocate. For his part, his judgment was entirely in favor of a continuance of the cooperative movement. After a general discussion of the conditions, it was unanimously decided to continue to cooperate and, at the same time, as afterward announced, the manufacturers present expressed the opinion that the developments required some change in prices. The new price list, as announced by the subsidiary companies of the United States Steel Corporation, not only met the cut on bars inaugurated by the action of the Republic Iron and Steel Company on May 24, but extended the reduction to all finished products except rails, wire and tin plate. In the announcement it was stated that it was believed that the reduction proposed by the United States Steel Corporation and its subsidiaries would be generally followed.

The luncheon of May 29, 1911, was the last meeting of the steel makers in connection with the cooperative movement. On July 1 following, the report of the Commissioner of Corporation on the Steel ( )Industry, with particular reference to the organization, investments, profits, and position of the United States Steel Corporation, appeared. The Stanley Committee on the investigation of the United States Steel Corporation was appointed in May, 1911, and held its first session on the 27th of that month. On October 26, 1911, the Attorney General of the United States filed a petition in the Circuit Court of the United States for the District of New Jersey, asking that the Corporation be dissolved and that the officers and stockholders be perpetually enjoined from the further continuance of acts which were alleged to be unlawful. In view of these attacks of the Government from three different sources, administrative, legislative, and legal, the cooperative meetings of the steel makers were finally and permanently abandoned and the Gary dinner system thus came to an end.

[illegible] delivered an address, the principal object of [illegible] been to determine whether it was the opinion [illegible] there that "the time for cooperation had gone by or [illegible]ld be suspended and each one should take care of [illegible] way, doing his own business in his own way, [illegible] and low be damned." The real question of issue was, [illegible] them, "whether or not you and your business can be [illegible] demonstrated by the disposition or the action of one individ- [illegible] few individuals in the trade. While, according to Mr. [illegible] had no wish or intention to make any agreement, express [illegible]ted, contrary to the law, it was his opinion that it was [illegible] important for the long future that the steel manufacturers [illegible] reference to what they were doing. His position never varied. [illegible] always ready to give the names of customers, the prices [illegible], and any information concerning the business, the mills [illegible] willing to reciprocate. For one part, his judgment was [illegible] favor of a continuance of the cooperative movement. [illegible] general discussion of the conditions, it was unanimously [illegible] to continue to cooperate and, at the same time, as after- [illegible] announced, the manufacturers present expressed the opinion [illegible] developments required some change in prices. The new [illegible], as announced by the subsidiary companies of the United [illegible] Corporation, not only met the cut, on bars inaugurated [illegible] of the Republic Iron and Steel Company on May 24, [illegible] the reduction to all finished products except rails, [illegible]plete. In the announcement it was stated that it was [illegible] on and its subsidiaries would be generally followed.

[illegible] noon of May 29, 1911, was the last meeting of the pre- [illegible] connection with the cooperative movement. On July 1 [illegible] the report of the Commissioner of Corporation on the [illegible] Industry, with particular reference to the organi- [illegible]ments, profits, and position of the United States Steel [illegible] appeared. The Stanley Committee on the investigation [illegible] States Steel Corporation was appointed in May, 1911, [illegible] session on the 27th of that month. On October [illegible] 1911, the Attorney General of the United States filed a petit[illegible] [illegible] Court of the United States for the District of [illegible] the Corporation be dissolved and that [illegible] be perpetually enjoined from the fu[illegible] were alleged to be unlawful. In view [illegible] government from three different sources [illegible], legislative, and legal, the cooperative [illegible] finally and permanently abandoned [illegible] to an end.

THE GARY DINNERS

From U.S. v. United States Steel Corporation, Transcript of Record, Government Exhibits, Vol. IV, Dist. Court, U.S. for Dist of N.J.

Cablegram to Gary, Chairman, Steel Corporation, New York:"Sorry cannot be with you at dinner tonight. Hope each will see advisability of maintaining present situation, as I believe active demand near at hand, and change will delay." -- Signed, Schwab.

Judge Gary: "I believe that in no line of business in the world at any time has there been such a large percentage of those engaged in a business as the percentage in this country who are going along day by day, hand in hand, pursuing the same course, anxious to promote and benefit the welfare of all the others. At this particular time there is not in this country a demand for more than fifty per cent of the total producing capacity in our lines. It is obvious from this statement of fact that there is not enough business to go around, and that there is no possible way of protecting one another and thereby protecting oneself except to submit ourselves to the conditions as they exist, and to take and be satisfied with our fair proportion of the business which is offered. It is not necessary, in this presence, to say that if one individual or company engaged in this business tries to secure or actually secures, for a day or a week, more than a fair proportion, still it simply means that in the long run that man or that company gets no more than his share; he has accomplished nothing whatever except to bring about demoralization, reduction of prices and heavy losses to all concerned, including himself. This is a logical proposition. No man is smart enough to long continue a practice which gives to him more than his fair share of business. He may succeed in one trade, he may get away from his friend or competitor his customer for a single transaction or two transactions; but it is just as certain that the competitor whose business has been taken away will the next day or the next week enter within the domain of the one who has first trespassed, taking away his business and adjusting, equalizing, bringing about at the end of the year or at some definite period simply the natural division of business and at greatly reduced prices. A nd there is no exception to this unless it be on the basis is of the strong man or the strong company having the advantage over his neighbors, if there is such a one, and he gets the business only by means which result in forcing his competitor out of business and in that way antagonizing the public interest and earning the condemnation not only of the public, but of the very government itself. Therefore it is impracticable. Now, in view of the fact that we have no right legally to enter into any arrangement by direct or indirect means which enables us to maintain prices, to divide territory, to restrict output, or in any way to interfere with the laws of trade or to stifle competition; in view of the fact that we cannot legally, directly or indirectly, do anything which may be construed to be in restraint of trade, and therefore are relegated to the one position of treating each other on the basis of fair, just and equitable treatment, it behooves us to use the greatest care in the exercise of our rights and in the transaction of our business, so as to make it absolutely certain that day by day, and with reference to every transaction we are certain to recognize the rights of our competitors, our friends, and the obligations which we are under towards

them. I say in this presence, to men who know by long experience--men who know to a demonstration that what I speak is true and logical--that we have something better to guide and control us in our business methods than a contract which depends upon written or verbal promises with a penalty attached. We as men, as gentlemen, as friends, as neighbors, having been in close communication and contact during the last few years, have reached a point where we entertain for one another respect and affectionate regard. We have reached a position so high in our lines of activity that we are bound to protect one another; and when a man reaches a position where his honor is at stake, where even more than life itself is concerned, where he cannot act or fail to act except with a distinct and clear understanding that his honor is involved, then he has reached a position that is more binding on him than any written or verbal contract. . . . At the present time the question of maintaining or changing the prices of the commodities in which we deal is uppermost in our minds, because we read and hear about this question every day and almost every hour. I have been pained, I admit, from time to time, to read in the newspapers that the United States Steel Corporation carried a big stick, and was in the habit of inviting the Independents, so-called, to come together for the purpose of lecturing them, or worse than that, of threatening them in case they proposed to reduce prices. I call upon you as witnesses to refute these insinuations. If it is just, if I have by my conduct or by my language induced any of you to suppose that I believe our Corporation has any advantage or is disposed to take any advantage, or has intended to urge you to fix or to maintain prices concerning your commodities which were not in accordance with your own views, I do not hesitate to ask your pardon. We make no claim for ourselves, except of the pride that we have in being your associates, and because you have given us your confidence, and you are willing to work with us. If any of you desire to lower prices at any time, and will make the fact known to me, you will find that I am a follower and not a stubborn opposer. I shall always beg leave to express my opinions in regard to what I think are fair prices, but I will do it not for the purpose of expecting you to adopt my views, nor for any purpose except the same purpose that you have in mind when you express to me your opinions. We deal in the open, we deal fairly, and, as I have frequently said, you will always find me an eary mark. If a majority of you shall be of the opinion that I am making a mistake in advocating the maintenance of prices you will have no difficulty in getting me to change my opinion; and, very fortunately, the Finance Committee of our Corporation which determines the policy of the Corporation, and which is made up of the biggest men we can get, are in accord with me concerning these views. They have always been willing to sustain me because they believe the positions taken are right. Now, my opinion is that it would be a mistake to reduce prices at this time; that it would do more harm than good; that instead of getting more business we would get less business; that the average purchaser, perhaps without exception, is not so much in favor of the reduction of prices, as he is in favor of making it absolutely certain his prices are the same prices that another has to pay for the same commodity. And the only reason in the mind of the proposed purchaser now, able and ready, willing and anxious to buy--the only reason for hesitation--is that he gets the impression in one way or another through the newspapers, and I fear frequently from our own subordinates, that there is a possibility in the future of a

reduction in prices, and he is therefore waiting for that time to come. . . . We are travelling together and we are going to stand together I believe without any interruption in the future, and if we do stand together there is nothing that can prevent the greatest success because it has been and shall be in every respect our intention and our decision to transact our business in such a way as to be sure we are fair and reasonable and also within the requirements of the law and the demands of the public interest. You may read in the newspapers hints that we are actually making agreements to maintain prices or that we are indirectly or by inference making arrangements which are in restraint of trade, and so we must make it certain that the contrary is true. I would not make an agreement under any circumstances to maintain prices or to do or regrain from doing anything which would prevent me from being absolutely independent from all others in every respect concerning every department of our Corporation, or in regard to the conduct of our business, and I would not ask for any different conclusion from others. As I said before, the very fact that it is understood we have this right, that we are independent, that we can go out of this room and do exactly as we please, without violating any agreement or understanding, and that all must depend upon the belief that as honorable men we are desirous of conducting ourselves and our business in such a way as not to injure our neighbors, must make each of us more careful in regard to the conduct of our affairs; and there will be no secrecy in what we do. You may say, 'Why aren't the newspaper reporters allowed in this room?' Because, in the first place, many of us, unaccustomed to speak in public, would hesitate to talk in the presence of newspaper men, and because more particularly we might fear we would be incorrectly reported."

James A. Farrell: "I understand the policy of the corporation to be to cooperate with its competitors in the effort to maintain fair prices, and the stability of business conditions, by every means permissible under the laws of the country and not antagonistic to the public conscience."

Willis L. King: ". . . I think therefore, to talk of reducing the prices ought not to be considered for a moment. As Judge Gary has very properly said, it would not result in good to any one, it would not result in more business to us, it would not do the public any good; therefore, I hope it will be the consensus of opinion here tonight that we will maintain the present prices, which are fair and reasonable, and await with patience the inevitable result which will of course be better business, and I think in the very near future."

E. C. Felton: "If there is anybody who thinks the present business situation will be improved, stimulated, by cutting prices, he ought to consider just one branch of our business; he should look at the facts and argue from those facts. Let him look at the pig iron situation. Now, in the pig iron situation there has been in a general way an open market; that is, prices have been met by everybody as they saw fit, and things have gone, as you know, down, down, down. When you go home, take up lase week's Iron Age, and look at the diagram that was printed in it, in which the production of pig iron is compared with the prices during 1910. You will find that the reduction in price not only did not stimulate consumption, but that

the production line went down faster than the price line. Now, what is true in that line of our business, will be true in every other line if we are foolish enough to go ahead and cut prices. I think, gentlemen, that is a lesson that we should all take to heart."

John A. Topping: "I am more convinced than ever that any efforts at this time to reduce prices with a view to stimulating consumption will be met in about the manner that Mr. Felton has illustrated. The price line will go down much faster than the production line will go up. There has been, as you know, an influence at work to undermine confidence, it has been an influence at work on our salesmen, and I believe that we all should get together and if we should do something to stiffen up the backbone of the salesmen, we would have real cooperation and real enthusiasm. Now, if we are going to have cooperation in the matter of policy, why should not we have cooperation all down the line. The way to get that cooperation, in my judgment, is to stimulate it. The feeling that we have ourselves around this table I think ought to go clear down the line. Our salesmen do not talk as we think. I think they should talk as we think. The way to bring that about is to do a little missionary work, each and every one of us, in the direction I have suggested. I have taken that work up myself and I am happy to say that it has so far, in a small way, seemed very effective."

Judge Gary: "Before I call the next speaker I would like to refer to two things. It is a fact that prices of some of our commodities have been materially reduced during the last two or three years. I think perhaps it would be a mistake for any of us to say that they have been reduced in all respects in reference to all lines to the point where they are now fair and reasonable, because it is the fact that they have been reduced in many respects below that point, and we would stultify ourselves if we were to say that two or three years ago they had not reached that point. You can see what I have in mind. I only want to call attention to the exact facts here so as to make it certain that none of us will unintentionally misrepresent the facts. In respect to some commodities, I am sure at the present time they are too low."

E. A. S. Clarke: "I believe it is an excellent thing to coach our salesmen along the lines Mr. Topping has suggested; but I submit I can easily conceive of a salesman having made his little talk to the purchaser and having been met with the single reply that So-and-So quotes lower prices. While I think it is well to coach salesmen, we must put into them the very same spirit I think we all have here that we are in honor bound not to change our prices without letting the other man know it, because then the salesman knows that he has an answer to give to that proposition. He knows that it is not so, he knows it is a juggling or play on words, some way that is given to try to shake his confidence and to induce him to lower his price to meet that price. I think if we can only instill in him the feeling that we have, that the other men will not lower the price, make him feel that it is simply an attempt to influence him in some way or other, we will stiffen him up to such an additional extent that we will have our businesses managed as we want them managed."

J. A. Campbell: "This is a very inspiring meeting and I am heartily in favor of everything that has been said, and you all know that both the policy of our company as directed by our directors and

myself is in harmony with the ideas of Judge Gary, and the men under him. I will do everything I can to promote that harmony in the future."

C. S. Price: "I will only speak of the business situation and endorse the fact that I consider it very inopportune at this time to make any change in prices. I do not believe that the customer wants it. It will tend to destroy stability, and while there is the keen pressure brought to bear in all directions, even going to the extent of untruths to accomplish the end, I think we would all see a repetition of what occurred in the spring of 1909, not more than a month or so later than this period of the year, where the prices were reduced, and business was not stimulated, and prices were again reduced in May, as I recollect, and the market thoroughly in the meantime demoralized, resulting in wage reductions which must follow. For that reason I think it would be a grave business mistake to in any way give out even an intimation that prices would be reduced. As we all know, as has been stated by the others, there is no necessity for a reduction in prices."

A. F. Huston: "We are all of the same opinion about the maintenance of prices. I heard the remark made by a prominent steel man last month. He said he had never seen a genuine buying movement without first a decided drop in prices to stimulate it. . . . Up to this time we have never had a chance to see whether a genuine buying movement would come without a severe drop. We have never had a chance to test it. It has all been one-sided. I believe the buying movement will come just as well if we stand up today as if we were to make a radical cut in the price."

G. M. Verity: "A certain grade of steel has a certain elastic limit and you cannot get any more out of it. Human nature can either lower its lower its elastic limit or raise it, and it is one of the problems of human nature that when it comes to competition that the elastic limit is very low. We are too much inclined at the first sign of reduction in prices to take it for granted and to use that as an excuse to go out and make lower prices and maybe get some attractive business. Now, I am certain that Judge Gary has proved, in his dealings with competitors and business interests generally, that his elastic limit is very high. I think we can all follow him in that respect and with great benefit to ourselves and business in general."

F. S. Witherbee: "I was very much impressed this fall in visiting Germany and having the opportunity to discuss matters with a very prominent iron and steel manufacturer in that country. He said that while we had the best plants and the largest output, etc., that the one glaring weakness with us in this country was the lack of stability in prices. He said, 'You never can succeed permanently in maintaining prices unless you meet frequently together. Now,' he said, 'the reason we in England, Germany, France and Belgium succeed in maintaining prices and stopping fluctuations is largely because we meet frequently and get together.' Now, I told him, which I am very glad to repeat here tonight, that we are getting closer together, thanks to Judge Gary and others, by these frequent dinners and meetings that we have had, and that we are no longer isolated as we were a few years ago. We are getting together and studying our differences,

with the idea of Judge Gary, and the men under everything I can to promote that harmony in the

: "I will only speak of the business situation and the fact that I consider it very improvident at this time any change in prices. I do not believe that the consumer

It will tend to destroy stability, and while there is pressure brought to bear in all directions, even going to the of authority to accomplish the end, I think we would not a repetition of what occurred in the spring of 1907, not more a month or so later than this period of the year, where the was reduced, and business was not stimulated, and prices w in May, as I recollect, and the market somewhat by in generalized, resulting in wage reductions which must some reason I think it would be a grave business mis- to try and give out over an impression that prices would be . As we all know, as has been stated by the chairman, there is for a reduction in prices."

: "We are all of the same opinion about the matter of prices. I heard the remark made by a prominent steel man month. He said he had never seen a speculative buying movement after a decided drop in prices to stimulate it. . . . Up to we have never had a chance to see another a genuine buying will come without a severe drop. We have never had a but it. It has all been pre-ticks. I believe the buying will come just as well if we stand up today as if we were a reduction out in the price."

: "A certain grade of steel has a certain elastic you cannot get one without the other. Human nature, either has lower its elastic limit or raise it, and it is one of the of human nature that when it comes to competition that the limit is very low. We are too much inclined at the time of reduction in prices to take it for granted and to see that to go out and make lower prices and maybe get some re- lines. Now, I am certain that Judge Gary has proved

is limit is very high. I think we can all follow his and with great benefit to ourselves and business in

: "I was very much impressed this fall in visiting the opportunity to address meetings with and steel manufacturers in that country. He said the best plants and the largest output, etc., that with us in this country was the lack of d, 'You never can succeed permanently in frequently together. Now, in Germany, France and Belgium manufacturers

and in a very short time I think we can meet the criticism of our German friend as to lack of stability in prices. Judge Gary and others started the movement by making the prices of rails practically stable, and there is no reason, it strikes me, why in time we should not make the prices of other articles we manufacture quite as stable as rails are today, or certainly much more than they have been in the past. I want here to publicly acknowledge to Judge Gary my personal gratitude for what he has done toward that end."

H. DuPuy: "I think the spirit of cooperation is a splendid one. We will strictly adhere to that idea."

David Reeves: "I am heartily in accord with the spirit that brings us together frequently at these conferences, and I think the policy that we have been pursuing is wonderfully vindicated now that we are producing only fifty per cent of our capacities, and no great demoralization in many lines has followed. I think we are to be congratulated in having a wise policy laid out for us and having followed it so well."

I. A. Kelly: "I heartily cooperate in everything that has been said here tonight, and so far as our company is concerned we are ready and willing to still cooperate to do what we can to maintain prices."

From Judge Buffington's opinion in U.S. v. United States Steel Corporation in the U.S. Dist. Court (223 Fed. 55, 1915):

"There is some dispute in the briefs concerning the essential characteristics of these meetings, but in our opinion, the real facts appear with sufficient clearness. We may begin the discussion by quoting the Government's concession in the original petition: 'It is not here alleged that merely assembling and mutually exchanging information and declaration of purpose amount to an agreement or a combination in restraint of trade.' With this concession we are in full accord. In these days every large business has its societies and associations, and these meet periodically to exchange information of all kinds, to compare experiences, to take note of improvements in machinery or process, to discuss problems, and generally to profit by the interchange of ideas and the study of observed facts. When the business is manufacturing, of course, all this has a direct bearing on the subject of prices, and these conferences may therefore consider that subject specifically. It is probably unusual, however, to find such a meeting making a declaration of intention to charge such and such prices, although a mere declaration to that effect could hardly be regarded as unlawful. Freedom of speech and freedom of individual action are justly prized in American society, and no legislation forbids men to come together and speak freely to each other about every detail of their common business. And if each individual should choose to announce at such a meeting the specific price he intends to charge for his wares, we are aware of no law that forbids him so to do. But at this point we approach debatable ground, for an individual is permitted to do some things that are denied to an association of individuals; and where at a meeting of many persons such action is taken whose legality is afterwards called in question, the decision may be vitally affected by ascertaining the fact whether the action was really taken by each individual

acting for himself, or whether those present were, in fact, pursuing a common object. This country has always been committed to the principle of fair and real competition in business--the struggle between individuals to sell goods in a market free from artificial control or influence--and the Sherman Act merely repeats this principle when it condemns, in the first section, 'every contract or combination in restraint of trade.' When, therefore, individuals or corporations make distinct contracts with each other, either in the form of pools or other agreements, dividing territory, limiting output, or fixing prices, there can be no question about the illegality of such contracts. And it makes no difference whether or not the agreement attempts to fix a penalty for its breach. The essence of the offense is that agreement; the penalty is merely an incident; so that a so-called 'gentlemen's agreement' to divide territory, etc., is quite as illegal as a formal pool with a formal penalty. In a gentlemen's agreement the sanction is the sense of honor, the moral obligation, the indefinite, but real, force that in some instances compel persons to keep their promises simply because they have promised. But suppose what happens is this: A number of persons take no action about territory or output, their discussions being mainly concerned with the subject of price, and suppose, further, that they refrain from making a definite formal agreement, and limit themselves to an understanding, a declaration of purpose--an announcement of intention--what, then, is to be said? Have they offended against the law? This question cannot be answered until we know that the participants were really doing. It is not enough to rest upon the varying names that may be given to the transaction. It is of the utmost importance to know how these names are to be interpreted, and this is the crucial matter to be looked for in the present record. . . . But we think the evidence makes it plain that a period of cooperation, or action with a common object, did begin in November, 1907, between the Steel Corporation and the great majority of its independent competitors, and that this period was chiefly marked by an understanding concerning the maintenance of price. Other matters were discussed at various meetings, but the principal concern was the subject of prices, and other subjects were subordinate. . . . Now to our minds the testimony taken as a whole makes the conclusion inevitable that the result of these meetings was an understanding about prices that was equivalent to an agreement. We have no doubt that among those present some silently dissented and went away intending to do what they pleased; but many, probably most, of the participants, understood and assented to the view that they were under some kind of an obligation to adhere to the prices that had been announced or declared as the general sense of the meeting. Certainly there was no positive and expressed obligation; no formal words of contract were used; but most of those who took part in these meetings went away knowing that prices had been named and feeling bound to maintain them until they saw good reason to do otherwise, and feeling bound to maintain them even then until they had signified to their associates their intention to make a change. We cannot doubt that such an agreement or understanding or moral obligation--whatever name may be the most appropriate-- amounts to a combination or common action forbidden by law. The final test, we think, is the object and the effect of the arrangement, and both the object and effect were to maintain prices, at least to a considerable degree. . . .It is only fair to add that in our opinion the participants in this movement did not intend to

act illegally. No doubt they did intend to exercise their full legal rights, but, of course, such exercise could not be wrong, and they believed they had succeeded in keeping within the proper limits. For the reasons given, we think they were mistaken; but we acquit them of trickiness or attempted evasion."

From Judge Woolley's separate opinion in the above case:

"In this the others acquiesced, and in the light of the emergency then existing, and the disaster averted, I am of opinion that the purpose and the conduct of those who participated in the first Gary dinner were not unlawful, improper, or questionable. But after the exigency had passed, and the means to meet it had been exerted, Gary dinners were found to be potential things, and they were afterwards called and employed to exert their potentiality, not in averting disaster, but in creating greater profits by raising and maintaining prices in periods of industrial calm. . . . The only difference between the Gary dinners and the meetings of the committees was that at the dinners the general business of the industry was discussed, while at committee meetings the business of a particular branch of the trade was discussed. At neither were agreements made concerning prices at which the participants would sell their products. In fact, it was asserted and reasserted that such agreements were impossible, because illegal; but in lieu of agreements, the parties, both at the dinners and at the committee meetings, severally made what they chose to call 'declarations of purpose'--that is, declarations of the prices at which they respectively proposed to sell their products, to which prices it is testified all adhered until some one chose to deviate therefrom, in which event he was 'in decency' bound to notify his dinner associates or the members of his committee. Excepting the feature of trade allotments and money penalties, Gary dinners were in effect pools, with the right reserved to each participant to withdraw upon notice to the others. They differed from pools only in the difference between the binding force of a moral understanding and the legal obligation of an express agreement. They were pools without penalties. They constituted a scheme which did not make it fatal for a competitor of the corporation to stay out, but made it attractive for him to stay in, the result of which was that prices were maintained with greater uniformity and stability than when the same participants engaged in pool agreements, violations of which carried penalties. . . The raising and maintaining of prices of steel products from 1901 to 1911 can not be attributed to the dominancy by the corporation over the industry, because of its size. It was due to cooperation between it and nearly all other producers in a joint effort to raise and maintain prices, in which they persisted and succeeded. Without the cooperation of independent producers, prices of steel products could not have been raised and maintained by the corporation alone. The offense of the corporation, therefore, was not its dominancy over the trade, but was an offense precisely similar to that of which every independent and cooperating producer was guilty, and consisted in the act of combining with its competitors to produce an unlawful result. If it had not combined with its competitors, or if they had not combined with it, restraint of trade, due to the fixation of prices, would, in my opinion, have been impossible. Therefore those who participated in such meetings, with the intention of doing that which was accomplished, participated in unlawfully restraining trade."

THE HARDWOOD LUMBER CASE
American Column and Lumber Co., et al. v. U.S., 257 U.S. 377, 1921.

Hardwood manufacturers operating mills in 18 states, principally in the southwest, and producing one-third of the total output, organized in 1918 into an association. Daily and monthly reports, in great detail, of sales, shipments, production and stocks on hand, were made to a central office, also monthly price lists showing prices f.o.b. shipping point. New prices were to be filed as soon as made. The secretary sent weekly and monthly summaries of these reports to the members, which disclosed the condition of each member of the association. A market letter with suggestions was sent out monthly. Meetings of the members were held monthly for discussion, and preceding these, a questionnaire was circulated, from the answers to which the secretary compiled an estimate of the condition of the market, for circulation at the meeting. Although the plan was supposed to deal only in close transactions, the communications of the secretary contained many suggestions concerning future policy which were discussed at the meetings.

This association was declared by the Supreme Court of the U.S. to be a conspiracy in restraint of interstate commerce under the Sherman Act. (American Column and Lumber Co., et al. v. U.S., 257 U.S. 377, 1921).

Said Justice Clarke, delivering the opinion of the Court:

"To call the activities of the defendants, as they are proved in this record, an 'Open Competition Plan' of action is plainly a misleading misnomer. Genuine competitors do not make daily, weekly and monthly reports of the minutest details of their business to their rivals, as the defendants did; they do not contract, as was done here, to submit their books to the discretionary audit and their stocks to the discretionary inspection of their rivals for the purpose of successfully competing with them; and they do not submit the details of their business to the analysis of an expert, jointly employed, and obtain from him a 'hormonized' estimate of the market as it is and as, in his specially and confidentially informed judgment, it promises to be. This is not the conduct of competitors but is so clearly that of men united in an agreement, express or implied, to act together and pursue a common purpose under a common guide that, if it did not stand confessed a combination to restrict production and increase prices in interstate commerce and as, therefore, a direct restraint upon that commerce, as we have seen that it is, that conclusion must inevitably have been inferred from the facts which were proved. To pronounce such abnormal conduct on the part wof 365 natural competitors, controlling one-third of the trade of the country in an article of prime necessity a 'new form of competition' and not an old form of combination in restraint of trade, as it so plainly is, would be for this court to confess itself blinded by words and forms to realities which men in general very plainly see and understand and condemn, as an old evil in a new dress and with a new name. The 'plan' is, essentially, simply an expansion of the gentlemen's agreement of former days, skilfully devised to evade the law."

The Hardware Lumber Case-2

Justice Holmes, dissenting, said:

"I should have thought that the ideal of commerce was an intelligent interchange made with full knowledge of the facts as a basis for a forecast of the future on both sides. A combination to get and distribute such knowledge, notwithstanding its tendency to equalize, not necessarily to raise, prices, is very far from a combination in unreasonable restraint of trade."

and Justice Brandeis, dissenting, with whom Justice McKenna concurred said:

"The evidence in this case, far from establishing an illegal restraint of trade, presents, in my opinion, an instance of commendable effort by concerns engaged in a chaotic industry to make possible its intelligent conduct under competitive conditions."

THE LINSEED OIL CASE

U.S. v. American Linseed Oil Co. et al. 262 U.S. 371, 1923.

Twelve corporations in six states manufacturing and distributing a large proportion, approximately three-fourths, of the linseed oil and by-products consumed throughout the country, having been active competitors, signed identical contracts in 1918 with the Armstrong Bureau of Related Industries under which statistical information, similar to that in the Hardwood Association, wasto be furnished to the Bureau, which in turn tabulated it for the benefit of the contracting corporations. But the agreement contemplated more rigid control than in the Association just described. Any subscriber could question the report of another and demand an investigation, and a member was compelled to turn over his books for examination. Any variations from price lists on file were to be reported by telegraph, including quantities, discounts and exact terms, and for shipments of more than a carload, the buyer's name and address and the f.o.b. point of shipment. The country was divided into eight zones for price quoting, and each member quoted a basic price for his own zone with specific additions for more distant zones. Uniform cash terms of settlement were agreed upon. Whenever an offer was refused by a prospective buyer, the member might request the Bureau to investigate, and report to the members the parties to the actual transaction and the terms of sale. At monthly meetings, members were "put on the carpet" and subjected to searching inquiry concerning their transactions. All information was for the exclusive and confidential use of the subscriber. Any failure to observe the terms of the agreement forfeited the advance deposit which each subscriber was obliged to make.

This "plan" was condemned under the Sherman Act in U.S. v. American Linseed Oil Co., et al. (262 U.S. 371, 1923).

Justice McReynolds, delivering the opinion of a unanimous Court said:

"Certain it is that the defendants are associated in a new form of combination and are resorting to methods which are not normal. If, looking at the entire contract by which they are bound together, in the light of what has been done under it the Court can see that its necessary tendency is to suppress competition in trade between the States, the combination must be declared unlawful. That such is its tendency, we think, must be affirmed. . . . With intimate knowledge of the affairs of other producers and obligated as stated, but proclaiming themselves competitors, the subscribers went forth to deal with widely separated and unorganized customers necessarily ignorant of the true conditions. Obviously they were not bona fide competitors; their claim in that regard is at war with common experience and hardly compatible with fair dealing. We are not called upon to say just when or how far competitors may reveal to each other the details of their affairs. In the absence of a purpose to monopolize or the compulsion that results from contract or agreement, the individual certainly may exercise great freedom; but concerted action through combination presents a wholly different problem and is forbidden when the necessary tendency is to destroy the kind of competition to which the public has long looked for protection. The situation here questioned is wholly unlike an exchange where dealers assemble and buy and sell openly; and the ordinary practice

of reporting statistics to collectors stops far short of the practice which defendants adopted. Their manifect purpose was to defeat the Sherman Act without subjecting themselves to its penalties."

That there was no dissenting opinion, as in the Hardwood Case, is probably due to the fact that this agreement involved a predominating proportion of the manufacturers in the industry, and that the terms of the agreement revealed much closer cooperation and more rigid control.

THE CEMENT CASE
Cement Manufacturers' Protective Association et al. v. U.S., 268 U.S. 588, 1925.

The Cement Manufacturers' Protective Association, organized in 1916, included 19 corporations manufacturing and shipping Portland cement and located in Pennsylvania, New Jersey, New York, Maryland and Virginia. The special features of the agreement included (a) reports and espionage with the object of restricting deliveries on "specific-job contracts" and thereby preventing contractors from securing future deliveries of cement, especially in a rising market, which they were not entitled to receive; and (b) compiling freight fate-books with rates from arbitrary basing points to numerous points of delivery. The Association involved the usual statistical organization with reports from and to members. Full stenographic reports of all discussions at the meetings were kept and made available to the Government and to the members of the Association. Counsel was present at the meetings to steer the discussion into safe channels.

Justice Stone, delivering the opinion of the Court, held that there was no violation of the Sherman Act. He said in part (Cement Manufacturers' Protective Association et al. v. U.S., 269 U.S 588, 1925):

"We do not see, however, in the activity of the defendants with respect to specific-job contracts, any basis for the contention that they constitute an unlawful restraint of commerce. . . . Nor, for the reasons stated, can we regard the gathering and reporting of information, through the cooperation of the defendants in this case, with reference to production, price of cement in actual closed specific-job contracts, and of transportation costs from chief points of production in the cement trade, as an unlawful restraint of commerce; even though it be assumed that the result of the gatheringand reporting of such information tends to bring about uniformity in price. Agreements or understanding among competitors for the maintenance of uniform prices are, of course, unlawful, and may be enjoined; but the government does not rely on any agreement or understanding for price maintenance. It relies rather upon the necessary leveling effect upon prices of knowledge disseminated among sellers as to some of the important factors which enter into price. It is conceded that there is a substantial uniformity of price of cement. Variations of price by one manufacturer are usually promptly followed by like variation throughout the trade. As already indicated, the larger proportion of the product of the defendants is distributed through dealers, and prices to dealers are not reported to or through the Association. It is contended by the government that the report of prices on specific-job contracts in effect informs the members of the Association of prices to dealers, since the differential allowed to dealers is well known in the trade. However this may be, the fact is that any change in quotations of price to dealers promptly becomes well known in the trade through reports of salesmen, agents, and dealers of various manufacturers. It appears to be undisputed that there were frequent changes in price, and uniformity has resulted not from maintaining the price at fixed levels, but in the prompt meeting of changes in

THE CHIEF JUSTICE

Manufacturers' Protective Association et al. v. U.S., 366 U.S. 356, 1956.

[illegible] Manufacturers Protective Association, organized in [illegible] to encourage manufacturing and employing furniture [illegible] located in Pennsylvania, New Jersey, New York, Maryland [illegible] Two special institutes of the association included (a) [illegible] and exchanges with the object of restricting delivery on [illegible] [illegible] delivery, or [illegible] they were not entitled to vouchers; and (b) compelling [illegible] dealers with orders from authorized [illegible] to immediate [illegible] of delivery. The association selected the usual [illegible] [illegible] transaction with manufacturers from and to retailers. Full accompanying [illegible] of all discussions at the meetings were kept and made available [illegible] to the Government and to the members of the Association. [illegible] was present as the meetings to direct the discussion [illegible] [illegible].

Justice Stone, delivering the opinion of the court, held [illegible] the violation of the Sherman Act. He said in part:

"[illegible]

"[illegible] to not see, however, in the validity of the defendants with [illegible] to accomplish-pad contracts, any bonus for the consideration that [illegible] an unlawful agreement or conspiracy. [illegible] [illegible] covered, can we regard the publishing and tabulating of [illegible] tion, through the cooperation of the defendants in this case, [illegible] to production, which of course in normal circumstances [illegible] to contribute, and of transportation costs from [illegible] of production in the domestic trade, as an unlawful restraint [illegible] even then, it is assumed that the equity of the [illegible] [illegible] of such information tends to bring about [illegible]

[illegible] of uniform prices are, of course, unlawful, and may [illegible] but the government does not rely on any agreement or [illegible] from price maintenance. It relies rather upon the [illegible] following effects upon prices of business in small [illegible] as to some of the important factors which enter into [illegible]. It is conceded that there is a substantial uniformity of [illegible] of costs. Variations of price by one manufacturer are usually followed by like variation throughout the trade. As [illegible], the larger proportion of the product of the [illegible] is distributed through dealers, and prices to dealers are [illegible] to or through the Association. It is contended by the [illegible] that the region of prices on depending-pad contracts is [illegible] the members of the Association from of prices to dealers [illegible] to dealers is well known in the [illegible] [illegible] that there is any change in price [illegible] dealers generally, however well known in the trade [illegible] of salesmen, agents, and dealers of various [illegible] appears to be undisputed that there were [illegible] and uniformity has resulted not from [illegible] but in the process of working of competition in [illegible]

prices by competing sellers. It is urged by the defendants that such uniformity of price as existed in the trade was due to competition. They offered much evidence tending to show complete independence of judgment and of action of defendants by large expenditures in competitive sales efforts and by variations in the volume of their production and shipment, earnings and profits. A great volume of testimony was also given by distinguished economists in support of the thesis that, in the case of a standardized product sold wholesale to fully informed professional buyers, as were the dealers in cement, uniformity of price will inevitably result from active, free and unrestrained competition, and the government, in its brief, concedes that 'undoubtedly the price of cement would approach uniformity in a normal market in the absence of all combinations between the manufacturers'. . . . But here the government does not rely upon agreement or understanding, and this record wholly fails to establish, either directly or by inference, any concerted action other than that involved in the gathering and dissemination of pertinent information with respect to the sale and distribution of cement to which we have referred, and it fails to show any effect on price and production except such as would naturally flow from the dissemination of that information in the trade and its natural influence on individual action. For reasons stated in Maple Flooring Mfrs. Asso. v. United States such activities are not in themselves unlawful restraints upon commerce, and are not prohibited by the Sherman Act."

To the decisions in the two last-mentioned cases, Chief Justice Taft and Justice Sanford dissented on the ground that these two cases did not differ substantially from the Hardwood and Linseed cases. Justice McReynolds rendered a separate dissenting opinion in which he said:

"These causes disclose carefully developed plans to cut down normal competition in interstate trade and commerce. Long impelled by this purpose, appellants have adopted various expedients through which they evidently hoped to defeat the policy of the law without subjecting themselves to punishment. They are parties to definite and unusual combinations and agreements, whereby each is obligated to reveal to confederates the intimate details of his business, and is restricted in his freedom of action. It seems to me that ordinary knowledge of human nature and of the impelling force of greed ought to permit no serious doubt concerning the ultimate outcome of the arrangements. We may confidently expect the destruction of that kind of competition long relied upon by the public for establishment of fair prices and to preserve which the Anti-trust Act was passed. United States v. American Linseed Oil Co. states the doctrine which I think should be rigorously applied. Pious protestations and smug preambles but intensify distrust when men are found busy with schemes to enrigh themselves through circumventions. And the government ought not to be required supinely to await the final destruction of competitive conditions before demanding relief through the courts. The statute supplies means for prevention. Artful gestures should not hinder their application."

The Trustee Device

From The Trust Problem by E liot Jones, Ph. D. p. 19-26.

The first resort to the trustee device or the "trust," as it will be called to di stinguish it from the modern trust, was by the Standard Oil Company. Prior to 1878 Mr. John D. Rockefeller and his associates had acquired a large number of oil concerns in the interest of the Standard Oil Company, but the shares of these concerns (instead of being held directly by the Standard Oil Company) had been registered in many cases in the names of various individualswho held them for the benefit of the company. In order to centralize more fully the control of these properties, it was decided in 1879 to organize the Standard Oil "trust."

The "trust" agreement as revised in January, 1882, included about forty companies, controlling from 90 to 95 per cent of the refining capacity of the country. It provided for nine trustees, among whom were Messrs. John D. Rockefeller, William Rockefeller, H. M. Flagler, and John Archbold. The trustees received from each of the parties to the agreement an assignment of their stock with voting power, and in return therefor gave "trust certificates" representing the valuation of the properties. The trustees did not become the owners of the stocks deposited with them; they simply held them in trust for the owners of the trust certificates. It should be noted, however, that these stocks were held by the trustees for the joint account rather than for the individual account of the certificate holders; a stockholder in any one company lost by the trust agreement his title to the stock of that particular company, and secured instead a proportionate interest in all the stocks and property held by the trustees. The trustees together owned 466,280 of the trust certificates out of a total of 700,000; and four of them held a majority of the trust certificates. They were thus able to elect the officers and directors of each of the constituent companies, and to manage the properties in complete harmony.

The trustees under this agreement were given powers substantially similar to those possessed by the directors of an ordinary holding company. They were to collect the interest and dividends on the securities held in trust, and to redistribute such portion thereof as they saw fit among the holders of the trust certificates. They were authorized to use any surplus trust funds to purchase the bonds and stocks of other companies engaged in the oil business, and to hold these securities for the benefit of the trust certificates. The centralized control provided for in the agreement made it possible for the trustees to dismantle those refineries that were poorly located, and to build new works at strategic points. Obviously it made no difference to the former owners of a given plant whether or not that plant was operated, since they received a certain percentage of the profits earned by all the companies. The trust agreement, further, made provision for the admission of new companies and individuals; for the formation, whenever advisable, of a Standard Oil Company in any state in the country. The duration of the agreement was to be for a period of twenty-one years after the death of the last surviving trustee, but provision was made for the termination of the agreement within one year of its execution upon the approval of nine-tenths of the certificates (in value), and within ten years upon the approval of two-thirds of the certificates.

Review #: 15

The Trusses Device

[illegible] by [illegible] Jones, Ed. D., p. 19-22.

[illegible] to resort to the trusses device or the "trust," as it [illegible] to it originally from the modern trust, was by the [illegible] tycoons. Prior to 1879 Mr. John D. Rockefeller and his [illegible] had acquired a large number of oil companies in the interior [illegible] and oil to carry out the change of these companies [illegible] held directly by the Standard Oil Company) had been [illegible] in many ways in the areas of various industrialists [illegible] for the benefit of the company. In order to centralize [illegible] the control of these associations, it was decided in 1879 [illegible] the Standard Oil "trust."

[illegible] agreement as revised on January, 1888, included [illegible] companies, controlling from 90 to 95 per cent of the [illegible] of the country. It involved the nine trustees, [illegible] John D. Rockefeller, William Rockefeller, [illegible] and John Archbold. The trustees resulted from [illegible] to the organization of which also with [illegible] the Russian Russian Boyd's trust, horizontal [illegible] [illegible] the trustees of the Standard corporations. In [illegible] fact, then these trustees were also in [illegible] for the joint economy taken from the industry. I consent [illegible] industry; a smooth older in any one company, [illegible] prevent it's title to the stock of their predecessor [illegible] and a power for good and economists interested to all [illegible] monopoly oil in the vicinity. The trustees together [illegible] of the trust controlled one or a total of 70,000,000 [illegible] a majority of the stock outstanding. [illegible] to start the officers and directors of each of the [illegible] companies, and to manage the properties in conformity [illegible]

[illegible] to the case possessed by the directors of an ordinary board [illegible] They were to conform the interest and dividends of the [illegible] in trust, and to reinstitute upon particular request [illegible] among the holders in the inner certificates. They [illegible] to see any profits from owning to purchase the [illegible] other companies or land in the oil business, and [illegible] been ultra for the benefit of the trust certificate [illegible] or [illegible] for the agreement [illegible] [illegible] the trustees to dissolve companies that were [illegible] and to build new works at suitable points. Finally [illegible] distribution of the [illegible] owners of a given plant [illegible] that was operated, since then received a certain [illegible] profits earned by all the companies. The owner [illegible] made provision for the admission of new companies [illegible] for the formation, whenever advisable, of [illegible] in any state in the country. The duration [illegible] period of twenty-one years [illegible] [illegible] but termination was made [illegible] within one year of the occurrence [illegible] of the conditions (in [illegible]), [illegible] of two-thirds of the certificates

The success of the Standard Oil "trust" invited imitation. In 1884 there was formed the American Cotton Oil "trust"; and in 1885 the National Linseed Oil "trust." The cotton oil "trust" included some seventy mills, located for the most part in the South, engaged in manufacturing and refining cotton seed oil. Its form of organization was precisely like that of the Standard. However, it soon met with difficulties on all sides, and in 1889 was reorganized as the American Cotton Oil Company.

In 1887 a "trust" was organized in the whisky business. From 1882 to 1887 some eighty distillers had maintained a precarious existence through pools. These pools, however, had proven unsatisfactory; it had not beenpossible to maintain them. Accordingly the leading distillers decided to establish a more compact organization modelled on the Standard Oil trust agreement of 1882. This was accomplished in May, 1887. The Distillers and Cattle Feeders' Trust, as the new organization was called, comprised about eighty companies, located mainly in New York, Ohio, Indiana, Illinois, Wisconsin, Missouri, and Nebraska, manufacturing 85 to 90 per cent of the total output of alcohol and spirits. There were nine trustees, who issued trust certificates in exchange for the shares of the corporations entering the "trust." Inasmuch as the trustees held a majority of the stock of every corporation, they were able to elect the directors and officers, and thus to control the management. This in turn enabled them to control the market, for instead of exporting the surplus at a loss, as had been done by the earlier pools, it was now possible to limit the output to the demand. It also lay within the power of the trustees to close up the poorest distilleries; and they did close some sixty-eight of them, the output beimg concentrated in the best equipped plants, with a consequent saving in the cost of production.

Another group resorting to the trustee device was the sugar refiners. During the seventies and eighties competition in the sugar refining industry had been quite keen; between 1867 and 1887 some thirty-six refineries had been closed. By 1887 there were left only twenty-six refineries, operated by twenty-three companies. The concerns that survived this period of severe competition were those that resorted to large-scale production, with its resulting economies. In August, 1887, seventeen of these companies, owning twenty-refineries, and possessing among them approximately 78 per cent of the refining capacity, entered into a trust agreement to become effective October 1, 1887.

In its main provisions this agreement was substantially like the trust agreements already described. Eleven trustees constituted a Board, known as the Sugar Refineries Company, and distributed trust certificates ($50,000,000) to the shareholders of the corporations in return for the securities held by them. The trustees thereupon caused themselves or their representatives to be elected directors of the separate corporations, and were thus able to manage the affairs of all in unison. It was provided that 15 per cent of the certificates allotted to the several companies should be left with the Board, and that these and any part of the $50,000,000 of certificates not allotted might be employed by the Board for the acquisition of other refineries or for certain other purposes. A unique feature of the sugar trust deed was a provision that no trustee should be interested directly or indirectly in the purchase or sale of sugar, whether for the purpose of speculation or otherwise, without the consent of a

majority of the Board. Of the twenty refineries acquired by the Sugar Refineries Company twelve were soon dismantled, and the other eight were consolidated into four.

In this same year (1887) there was organized the National Lead Trust and the Cordage "trust." The latter, known as the National Cordage Association, controlled at this time only 30 per cent of the country's output of rope and cordage; it was not until 1891 that it attained a monopolistic position in the industry.

The organization of these "trusts" was followed by a general outcry against monopolies. How fully the attention of the public had been called to the establishment of the "trusts," and what its reaction was, is shown by the numerous laws forbidding combinations and trusts enacted by the state legislatures from 1889 to 1893, and by the passage by the National Congress in 1890 of the Sherman Anti-trust Act, which prohibited every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, and every monopoly or attempt to monopolize. And as it soon proved, the "trusts" were particularly vulnerable, much more so than the pools. The pools, it is true, were unlawful, but they were secret agreements, and therefore were to some extent free from attack. The Addyston Pipe and Steel Company is the most conspicuous instance of a pool dissolved by legal process, and the evidence here was obtained only because a disgruntled stenographer painstakingly accumulated it. The trust agreements of the eighties, however, were tangible matters of record. There was a formal transfer by the stockholders of their legal title to the stock of the constituent companies, as a consideration forwhich they received trust certificates. The rights of the members were clearly defined in the trust agreement. The fact could not be concealed that these companies, whose corporate existence had been preserved, had almost completely sacrificed their independence.

Hardly had the "trusts" been created when legal proceedings were instituted against them. The state of Louisiana attacked the cotton oil "trust"; the state of Nebraska, the whisky "trust"; the state of New York, the sugar "trust"; and the state of Ohio, the oil "trust." The action against the sugar "trust" came in 1888. In that year the Attorney General of New York State brought suit under the common law against the North River Sugar Refining Company, a New York corporation, praying that the charter of the company be vacated and the company dissolved. In a decision rendered in June, 1890, the Circuit Court of Appeals decided against the company. The court held that the North River Sugar Refining Company, in entering the "trust," had given over the control of its affairs to an irresponsible board, and that such delegation of its essential corporate powers was a perversion of the privileges conferred by the company's charter. Furthermore, the court held that the company had helped to create a trust which, in substance and effect, was a partnership of separate corporations, and for corporations to enter a partnership was illegal. The company's charter, therefore, was taken away, and its corporate existence terminated.

The Standard Oil "trust" agreement was likewise condemned by the courts. In May, 1890, the Attorney General of Ohio filed a petition against the Standard Oil Company of Ohio, charging that the company had violated the laws of the state by placing the control of its affairs in the hands of trustees, nearly all of

whom were nonresidents of the state. Great pressure was brought to bear on the Attorney General to induce him to discontinue the suit, but without success. The decision of the Supreme Court was rendered in March, 1892. As in New York State, the "trust" arrangement was declared illegal, though the Ohio court put more emphasis on the creation of a monopoly. The court said: "the observance (of this agreement) must subject the defendant (the Standard Oil Company of Ohio) to a control inconsistent with its character as a corporation. . . The law requires that a corporation should be controlled and managed by its directors in the interests of its own stockholders, and conformable to the purpose for which it was created by the laws of its state. By this agreement, indirectly, it is true, but none the less effectually, the defendant is controlled and managed by the Standard Oil Trust, an association with its principal place of business in New York City, and organized for a purpose contrary to the policy of our laws. Its object was to establish a virtual monopoly of the business of producing petroleum, and of manufacturing, refining and dealing in it and all its products, throughout the entire country, and by which it might not merely control the production, but the price at its pleasure. All such associations are contrary to the policy of our state and void." The court did not order the dissolution of the Standard Oil Company, as urged in the petition, but simply commanded it to cease its connection with the "trust."

Any expectation that the decision of the Supreme Court of Ohio would put an end to the oil monopoly proved to be unfounded when the nature of the dissolution became apparent. On March 21, 1892, at a meeting of the trust certificate holders, a resolution terminating the "trust" was adopted. At this time the stocks of eighty-four companies were held by the Standard Oil trustees. On April 1 the stocks of sixty-four of these corporations were transferred to some one of the remaining twenty. This left the stocks of twenty companies in the hands of the trustees, and these they proceeded to distribute among the holders of the trust certificates. There were outstanding at this time $97,250,000 trust certificates. The trustees, who became liquidating trustees, divided the stock of each of the twenty companies into 972,500 parts. They then offered to give to each trust certificate holder in exchange for each share 1/972,500 part of the stock of each one of the twenty corporations. The only ones who accepted this offer were the trustees (themselves the largest certificate holders) and the members of their families and their immediate associates. The smaller trust certificate holders were discouraged from liquidating by the fact that they would have received only fractional shares in the twenty companies, and these companies declined to pay dividends on fractional shares. Dividends continued to be paid, however, on the trust certificates when not liquidated. The nine trustees, therefore, became the holders of the majority of the stocks of the twenty companies, and as liquidating trustees they also held the stocks not exchanged for trust certificates. This dissolution obviously was nominal; it effected no real change in the situation. In fact, Mr. Archbold admitted before the Industrial Commission that the companies worked together after the dissolution as harmoniously as before.

It was apparent that the Standard interests had not attempted to obey the court's order, but had stooped to a mere subterfuge. A new suit, therefore, was instituted in 1897 against the Standard Oil Company for failure to obey the court's decree of March, 1892. This suit dragged along until December, 1900, when it was dismissed. Meanwhile the Standard Oil Company had reorganized as a holding company.

Standard Oil Trust Agreement of 1879.& 1882

Stevens - Industrial Combinations and Trusts - pages 14-27.

Whereas the Standard Oil Company of Cleveland, Ohio, holds the possession of certificates for certain stocks and interests which it is desirable to distribute among the parties entitled thereto; and whereas such stocks and interests now stand in the names of several persons, and it is desirable for convenience in dividing them that all be transferred to trustees, and that the same be so transferred by the Standard Oil Company, by each party holding the same, and by every person holding or claiming an interest therein.

Now, in consideration of the foregoing, and of the sum of one dollar to us paid, and other considerations satisfactory to us, we, the undersigned, hereby grant, assign, transfer, and convey all our right, title, and interest and all the right, title, and interest of each and every one of us of whatever name and nature in and to all and singular the following-described stocks and interests, to-wit:

Entire capital stock of Long Island Oil Company.
2700 shares capital stock of Devoe Manufacturing Co.
Entire capital stock of Charles Pratt & CO.
5,059 shares capital stock of Baltimore United Oil Co.
525 shares capital stock of Keystone Refining Co.
Entire capital stock of Sone & Fleming Manufacturing Co., Limited.
Entire capital stock of Atlantic Refining Co.
Entire capital stock of Standard Oil Co. (of Pennsylvania).
Entire capital stock of Model Oil Co.
1,775 shares capital stock of American Lubricating Oil Co.
Entire capital stock of Camden Consolidated Oil Co.
2,268 shares capital stock of Central Refining Co.
700 shares capital stock of Maverick Oil Co.
Entire capital stock of Republic Refining Co.
400 shares capital stock of Waters-Pierce Oil Co.
300 shares capital stock of Consolidated Tank Line Co.
Entire capital stock of American Transfer Co.
41,590 shares capital stock of United Pipe Lines.
Entire interest in and capital stock of Paine, Ablett & Co., Limited.
145/175ths of entire interest in and capital stock of Eclipse Lubricating Oil Co., Limited.
3/4ths of entire interest in and capital stock of H. C. Van Tine & Co. (Limited).
7/8ths of entire interest in and capital stock of Galena Oil Works (Limited).
Entire capital stock of Smith's Ferry Oil Transpn. Co.
14,713 (old) shares stock and interest in Producers' Consolidated Land & Petroleum Co.
Special investment at Oil City, Pa.
Business and property of Star Oil Co., Erie, Pa.
Business and property of Warden, Frew & Co., Philadelphia, Pa.
Entire capital stock of Philadelphia Refining Co.
Entire capital stock of Olean Petroleum Co. (Limited).
Entire capital stock of Columbia Conduit Co. and also all other interests of every kind and description held by the Standard Oil Company or in which it has any interest which can be or by right ought to be divided and distributed among the parties entitled thereto, without affecting its proper, legitimate, and efficient operations as a corporation, to Myron R. Keith, George F. Chester,

and George H. Vilas, as trustees, to have and to hold said stocks and interests to them and their survivors and successors, in trust nevertheless for the following purposes, to wit: To hold, control and manage the said stocks and interests for the exclusive use and benefit of the following-named persons and in the following proportions named:

Charles Pratt 2700/35000 thereof, Horace A. Pratt 15/35000, Henry H. Rogers 910/35000, C. M. Pratt 200/35000, Wm. Rockefeller 1600/35000, O. B. Jennings 818/35000, W. H. Macy 59/35000, W. H. Macy, jr. 25/35000, Estate of Josiah Macy 892/35000, A. J. Pouch 178/35000, J. A. Bostwick 1872/35000, Warden, Frew & Co. 485/35000, Chas. Lockhart 1408/35000, Wm. C. Warden 1292/35000, O. H. Payne, trustee 61/35000, S. V. Harkness 2925/35000, H. M. Flagler 3000/35000, Daniel Bushnell 97/35000, Jos. L. Warden 98/35000, J. J. Vandergrift 500/35000, F. A. Arter 35/35000, Gustave Heye 178/35000, L. G. Harkness 178/35000, Hanna & Chapin 263/35000, A. M. McGregor 118/35-000, D. Brewster 409/35000, W. C. Andrews 990/35000, Horace A. Hutchins 111/35000, John D. Archbold 350/35000, John D. Rockefeller 8984/35000, J. N. Camden 200/35000, W. P. Thompson 132/35000, D. M. Harkness 323/35000, O. H. Payne 2637/35000, John Huntington 584/35000, W. T. Wardell 78/35000, H. W. Payne 292/35000

and to divide and distribute the same as soon as they can conveniently do so between the said persons for whose benefit they hold the same as aforesaid, and in the respective proportions aforesaid; with full power and authority to the survivors of the said trustees in case of the death of either of them to nominate and appoint a successor to such deceased trustee if they shall think it expedient so to do or else to continue the said trust without filling such vacancy.

In witness whereof the Standard Oil Co. has, by its president and secretary, duly authorized thereto, set its name and affixed its corporate seal, and the others of the undersigned have hereto set their hands and seals this eighth day of April, A. D. 1879.

Standard Oil Company,
By John D. Rockefeller, Prest.

Attest:
H. M. Flagler, Secy.
(Here follows list of signatures.)

- - - - -

Standard Oil Trust Agreement and Supplemental Trust Agreement of 1882

This agreement, made and entered upon this second day of January A. D. 1882, by and between all the persons who shall now or may hereafter execute the same as parties thereto, witnesseth:

I. It is intended that the parties to this agreement shall embrace three classes, to-wit:

(1) All the stockholders and members of the following corporations and limited partnerships, to wit:

Acme Oil Co. (New York), Acme Oil Co. (Pennsylvania), Atlantic Refining Co., of Phila.; Bush & Co. Limited, Camden Consolidated Oil Co., Elizabethport Acid Works, Imperial Refining Co., Limited, Chas. Pratt & Co., Paine, Ablett & Co., Limited, Standard Oil Co. (Ohio), Standard Oil Co. (Pittsburg), Smith's Ferry Oil Trans. Co., Solar Oil Co. Limited, Sone & Fleming Mfg. Co., Limited.

Also all the stockholders and members of such other corporations and limited partnerships as may hereafter join in this

agreement at the request of the trustees herein provided for.

(2) The following individuals, to wit:
W. C. Andrews, John D. Archbold, Lide K. Arter, J. A. Bostwick, Benj. Brewster, D. Bushnell, Thomas C. Bushnell, J. N. Camden, Henry L. Davis, H. M. Flagler, Mrs. H. M. Flagler, H. M. Hanna, and George W. Chapin, D. M. Harkness, D. M. Harkness, trustee; S. V. Harkness, John Huntington, H. A. Hutchins, Chas. F. G. Heye, O. B. Jennings, Chas. Lockhart, A. M. McGregor, Wm. H. Macy, Wm. H. Macy jr., estate of Josiah Macy, jr., Wm. H. Macy, jr., executor; O. H. Payne, O. H. Payne, trustee; Chas. Pratt, Horace A. Pratt, C. M. Pratt, A. J. Pouch, John D. Rockefeller, Wm. Rockefeller, Henry H. Rogers, W. P. Thompson, J. J. Vandergrift, Wm. T. Wardwell, W. G. Warden, Joseph L. Warden; Warden, Frew & Co., Louise C. Wheaton, Julia H. York, George H. Vilas, M. R. Keith, Geo. F. Chester, trustees.

Also all such individuals as may hereafter join in this agreement at the request of the trustees herein provided for.

(3) A portion of the stockholders and members of the following corporations and limited partnerships, to wit:
American Lubricating Oil Co., Baltimore United Oil Co., Beacon Oil Co., Bush & Denslow Manuf'g Co., Central Refining Co., of Pittsburg; Chesebrough Manuf'g Co., Chess-Carley Co., Consolidated Tank Line Co., Inland Oil Co., Keystone Refining Co., Maverick Oil Co., National Transit Co., Portland Kerosene Oil Co., Producers' Con'd Land and Petroleum Co., Signal Oil Works, Limited, Thompson and Bedford Co., Limited, Devoe Manuf'g Co., Eclipse Lubricating Oil Co., Limited, Empire Refining Co., Limited, Franklin Pipe Co., Limited, Galena Oil Works, Limited, Galena Farm Oil Co., Limited, Germania Mining Co., Vacuum Oil Co., H. C. Van Tine & Co., Limited, Waters-Pierce Oil Co.

Also stockholders and members (not being all thereof) of other corporations and limited partnerships who may hereafter join in this agreement at the request of the trustees herein provided for.

II. The parties hereto do covenant and agree to and with each other, each in consideration of the mutual covenants and agreements of the others, as follows:

(1) As soon as practicable a corporation shall be formed in each of the following States, under the laws thereof, to-wit: Ohio, New York, Pennsylvania and New Jersey; provided, however, that instead of organizing a new corporation, any existing charter and organization may be used for the purpose when it can advantageously be done.

(2) The purposes and powers of said corporations shall be to mine for, produce, manufacture, refine, and deal in petroleum and all its products, and all the materials used in such business, and transact other business collateral thereto. But other purposes and powers shall be embraced in the several charters such as shall seem expedient to the parties procuring the charter, or, if necessary to comply with the law, the powers aforesaid may be restricted and reduced.

(3) At any time hereafter, when it may seem advisable to the trustees herein provided for, similar corporations may be formed in other States and Territories.

(4) Each of said corporations shall be known as the Standard Oil Co. of _____(and here shall follow the name of the State or Territory by virtue of the laws of which said corporation is organized).

(5) The capital stock of each of said corporations shall be fixed at such an amount as may seem necessary and advisable to the parties organizing the same, in view of the purpose to be accomplished.

(6) The shares of stock of each of said corporations shall be issued only for money, property, or assets equal at a fair valuation to the par value of the stock delivered therefor.

(7) All of the property, real and personal, assets, and business of each and all of the corporations and limited partnerships mentioned or embraced in class (1) shall be transferred to and vested in the said several Standard Oil companies. All of the property, assets, and business in or of each particular State shall be transferred to and vested in the Standard Oil Co. of that particular State, and in order to accomplish such purpose the directors and managers of each and all of the several corporations and limited partnerships mentioned in class first are hereby authorized and directed by the stockholders and members thereof (all of them being parties to this agreement) to sell, assign, transfer, convey, and make over, for the consideration hereinafter mentioned, to the Standard Oil Co. or companies of the proper State or States, as soon as said corporations are organized and ready to receive the same, all the property, real and personal, assets, and business of said corporations and limited partnerships. Correct schedules of such property, assets, and business shall accompany each transfer.

(8) The individuals embraced in class second of this agreement do each for himself agree, for the consideration hereinafter mentioned, to sell, assign, transfer, convey, and set over all the property, real and personal, assets, and business mentioned and embraced in schedules accompanying such sale and transfer to the Standard Oil Company or Companies of the proper State or States, as soon as the said corporations are organized and ready to receive the same.

(9) The parties embraced in class third of this agreement do covenant and agree to assign and transfer all of the stock held by them in the corporations or limited partnerships herein named, to the trustees herein provided for, for the consideration and upon the terms hereinafter set forth. It is understood and agreed that the said trustees and their successors may hereafter take the assignment of stocks in the same or similar companies upon the terms herein provided, and that whenever and as often as all the stocks of any corporation and limited partnership are vested in said trustees the proper steps may then be taken to have all the money, property, real and personal, of said corporation or partnership assigned and conveyed to the Standard Oil Company of the proper State on the terms and in the mode herein set forth, in which event the trustees shall receive stocks of the Standard Oil Company equal to the value of the money, property, and business assigned, to be held in place of the stocks of the company or companies assigning such property.

(10) The consideration for the transfer and conveyance of the money, property, and business aforesaid to each or any of the Standard Oil Companies shall be stock of the respective Standard Oil Company to which said transfer or conveyance is made, equal at par value to the appraised value of the money, property, and business so transferred. Said stock shall be delivered to the trustees hereinafter provided for, and their successors, and no stock of any of said companies shall ever be issued except for money, property,

or business equal at least to the par value of the stock so issued, nor shall any stock be issued by any of said companies for any purpose except to the trustees herein provided for, to be held subject to the trusts hereinafter specified. It is understood, however, that this provision is not intended to restrict the purchase, sale, and exchange of property of said Standard Oil Companies as fully as they may be authorized to do by their respective charters, provided only that no stock be issued therefor except to said trustees.

(11) The consideration for any stock delivered to said trustees as above provided for, as well as for stocks delivered to said trustees by persons mentioned or included in class third of this agreement, shall be the delivery by said trustees, to the persons entitled thereto, of trust certificates hereinafter provided for, equal at par value to the par value of the stocks of the said Standard Oil companies so received by said trustees, and equal to the appraised value of the stocks of other companies or partnerships delivered to said trustees. (The said appraised value shall be determined in a manner agreed upon by the parties in interest and said trustees.) It is understood and agreed, however, that the said trustees may, with any trust funds in their hands, in addition to the mode above provided, purchase the bonds and stocks of other companies engaged in business similar or collateral to the business of said Standard Oil companies on such terms and in such mode as they may deem advisable, and shall hold the same for the benefit of the owners of said trust certificates, and may sell, assign, transfer, and pledge such bonds and stocks whenever they may deem it advantageous to said trust so to do.

III. The trusts upon which said stocks shall be held, and the number, powers, and duties of said trustees, shall be as follows:

(1) The number of trustees shall be nine.

(2) J. D. Rockefeller, O. H. Payne, and Wm. Rockefeller are hereby appointed trustees, to hold their office until the first Wednesday of April, A. D. 1885.

(3) J. A. Bostwick, H. M. Flagler, and W. G. Warden are hereby appointed trustees, to hold their office until the first Wednesday of April, A. D. 1884.

(4) Chas. Pratt, Benj. Brewster, and John D. Archbold, are hereby appointed trustees, to hold their office until the first Wednesday of April, A. D. 1883.

(5) Elections for trustees to succeed those herein appointed shall be held annually, at which election a sufficient number of trustees shall be elected to fill all vacancies occurring either from expiration of the term of office of trustee or from any other cause. All trustees shall be elected to hold their office for three years, except those elected to fill a vacancy arising from any cause expiration of term, who shall be elected for the balance of the term of the trustee whose place they are elected to fill. Every trustee shall hold his office until his successor is elected.

(6) Trustees shall be elected by ballot by the owners of trust certificates or their proxies. At all meetings the owners of trust certificates who may be registered as such on the books of the trustees may vote in person or by proxy, and shall have one vote for each and every share of trust certificates standing in their names; but no such owner shall be entitled to vote upon any share which has not stood in his name thirty days prior to the day appointed for the election. The transfer books may be closed for thirty days immediately preceding the annual election, A majority of the shares represented at such election shall elect.

(7) The annual meeting of the owners of said trust certificates for the election of trustees and for other business shall be held at the office of the trustees in the city of New York on the first

Wednesday of April of each year, unless the place of meeting be changed by the trustees, and said meeting may be adjourned from day to day until its business is completed. Special meetings of the owners of said trust certificates may be called by the majority of the trustees at such times and places as they may appoint. It shall also be the duty of the trustees to call a special meeting of holders of trust certificates whenever requested to do so by a petition signed by the holders of 10 per cent in value of such certificates. The business of such special meetings shall be confined to the object specified in the notice given therefor. Notice of the time and place of all meetings of the owners of trust certificates shall be given by personal notice as far as possible and by public notice in one of the principal newspapers in each State in which a Standard Oil Co. exists at least ten days before such meeting. At any meeting, a majority in the value of the holders of trust certificates represented consenting thereto, by-laws may be made, amended, or repealed relative to the mode of election of trustees and other business of the holders of trust certificates; provided, however, that said by-laws shall be in conformity with this agreement. By-laws may also be made, amended, and repealed at any meeting, by and with the consent of a majority in value of the holders of trust certificate which alter this agreement relative to the number, powers, and duties of the trustees and to other matters tending to the more efficient accomplishment of the objects for which the trust is created, provided only that the essential intents and purposes of this agreement be not thereby changed.

(8) Whenever a vacancy occurs in the board of trustees more than sixty days prior to the annual meeting for the election of trustees, it shall be the duty of the remaining trustees to call a meeting of the owners of the Standard Oil Trust certificates for the purpose of electing a trustee or trustees to fill the vacancy or vacancies. If any vacancy occurs in the board of trustees, from any cause, within sixty days of the date of the annual meeting for the election of trustees, the vacancy may be filled by a majority of the remaining trustees, or, at their option, may remain vacant until the annual election.

(9) If, for any reason, at any time, a trustee or trustees shall be appointed by any court to fill any vacancy or vacancies in said board of trustees, the trustee or trustees so appointed shall hold his or the representive office or offices only until a successor or successors shall be elected in the manner above provided for.

(10) Whenever any change shall occur in the board of trustees, the legal title to the stock and other property held in trust shall pass to and vest in the successors of said trustees without any formal transfer thereof; but if at any time such formal transfer shall be deemed necessary or advisable it shall be the duty of the board of trustees to obtain the same, and it shall be the duty of any retiring trustee, or the administrator or executor of any deceased trustee, to make said transfer.

(11) The trustees shall prepare certificates, which shall show the interest of each beneficiary in said trust, and deliver them to the persons properly entitled thereto. They shall be divided into shares of the par value of $100 each, and shall be known as "Standard Oil Trust Certificates," and shall be issued subject to all the terms and conditions of this agreement. The trustees shall have power to agree upon and direct the form and contents of said certificates, and the mode in which they shall be signed, attested, and transferred. The certificates shall contain an express stipulation that the holders thereof shall be bound by the terms of this agreement, and by the by-laws herein provided for.

(12) No certificates shall be issued except for stocks and bonds

held in trust, as herein provided for, and the par value of certificates issued by said trustees shall be equal to the par value of the stocks of said Standard Oil Companies, and the appraised value of other bonds and stocks held in trust. The various bonds, stocks, and moneys held under said trust shall be held for all parties in interest jointly, and the trust certificates so issued shall be the evidence of the interest held by the several parties in this trust. No duplicate certificates shall be issued by the trustees except upon surrender of the original certificate or certificates for cancellation, or upon satisfactory proof of the loss thereof, and in the latter case they shall require a sufficient bond of indemnity.

(13) The stocks of the various Standard Oil Companies held in trust by said trustees shall not be sold, assigned, or transferred by said trustees, or by the beneficiaries, or by both combined, so long as the trust endures. The stocks and bonds of other corporations held by said trustees may be by them exchanged or sold and the proceeds thereof distributed pro rata to the holders of trust certificates, or said proceeds may be held and reinvested by said trustees for the purposes and uses of the trust; provided, however, that said trustees may from time to time assign such shares of stock of said Standard Oil Companies as may be necessary to qualify any person or persons chosen or to be chosen as directors and officers of any of said Standard Oil Companies.

(14) It shall be the duty of said trustees to receive and safely to keep all interest and dividends declared and paid upon any of the said bonds, stocks, and moneys held by them in trust, and to distribute all moneys received from such sources or from sales of trust property or otherwise by declaring and paying dividends upon the Standard Trust certificates as funds accumulate, which in their judgment are not needed for the uses and expenses of said trust. The trustees shall, however, keep separate accounts and receipts from interest and dividends, and of receipts from sales or transfers of trust property, and in making any distribution of trust funds, in which moneys derived from sales or transfers shall be included, shall render the holders of trust certificates a statement showing what amount of the fund distributed has been derived from such sales or transfers. The said trustees may be also authorized and empowered by a vote of a majority in value of holders of trust certificates, whenever stocks or bonds have accumulated in their hands from money purchases thereof, or the stocks, or bonds held by them have increased in value, or stock dividends shall have been declared by any of the companies whose stocks are held by said trustees, or whenever from any such cause it is deemed advisable so to do, to increase the amount of trust certificates to the extent of such increase or accumulation of values and to divide the same among the persons then owning trust certificates pro rata.

(15) It shall be the duty of said trustees to exercise general supervision over the affairs of said several Standard Oil Companies, and as far as practicable over the other companies or partnerships, any portion of whose stock is held in said trust. It shall be their duty as stockholders of said companies to elect as directors and officers thereof faithful and competent men. They may elect themselves to such positions when they see fit so to do., and shall endeavor to have the affairs of said companies managed and directed in the manner they may deem most conducive to the best interests of the holders of said trust certificates.

(16) All the powers of the trustees may be exercised by a majority of their number. They may appoint from their own number an executive and other committees. A majority of each committee shall

exercise all the powers which the trustees may confer upon such committee.

(17) The trustees may employ and pay all such agents and attorneys as they may deem necessary in the management of said trust.

(18) Each trustee shall be entitled to a salary for his services not exceeding twenty-five thousand dollars per annum, except the president of the board, who may be voted a salary not exceeding thirty thousand dollars per annum, which salaries shall be fixed by said board of trustees. All salaries and expenses connected with or growing out of the trust shall be paid by the trustees from the trust fund.

(19) The board of trustees shall have its principal office in the city of New York, unless changed by vote of the trustees, at which office, or in some place of safe deposit in said city, the bonds and stocks shall be kept. The trustees shall have power to adopt rules and regulations pertaining to the meetings of the board, the election of officers, and the management of the trust.

(20) The trustees shall render at each annual meeting a statement of the affairs of the trust. If a termination of the trust be agreed upon, as hereinafter provided, or within a reasonable time prior to its termination by lapse of time, the trustees shall furnish to the holders of the trust certificates a true and perfect inventory and appraisement of all stocks and other property held in trust, and a statement of the financial affairs of the various companies whose stocks are held in trust.

(21) The trust shall continue during the lives of the survivors and survivor of the trustees in this agreement named, and for twenty-one years thereafter; provided, however, that if at any time after the expiration of ten years two-thirds of all the holders in value, or if after the expiration of one year 50 per cent of all the holders in value of trust certificates shall, at a meeting of holders of trust certificates called for that purpose, vote to terminate this trust at some time to be by them then and there fixed, the said trust shall terminate at the date so fixed. If the holders of trust certificates shall vote to terminate the trust as aforesaid, they may, at the same meeting, or at a subsequent meeting called for that purpose, decide by vote of two-thirds in value of their number the mode in which the affairs of the trust shall be wound up, and whether the trust property shall be distributed or whether part, and if so, what part shall be divided and what part sold, and whether such sales shall be public or private. The trustees, who shall continue to hold their offices for that purpose, shall make the distribution in the mode directed, or, if no mode be agreed upon, by two-thirds in value as aforesaid, the trustees shall make distribution of the trust property according to law. But said distribution, however made, and whether it be of property, or values, or of both, shall be just and equitable, and such as to insure to each owner of a trust certificate his due proportion of the trust property or the value thereof.

(22) If the trust shall be terminated by the expiration of the time for which it is created, the distribution of the trust property shall be directed and made in the mode above provided.

(23) This agreement, together with the registry of certificates, books of accounts, and other books and papers connected with the business of said trust, shall be safely kept at the principal office of said trustees.

Signatures.)

SUPPLEMENTAL AGREEMENT

Whereas in and by an agreement dated January 2, 1882, and known as the Standard Trust agreement, the parties thereto did mutually covenant and agree, iter alia, as follows, to wit: That corporations to be known as Standard Oil Companies of various States should be formed, and that all of the property, real and personal, assets, and business of each and all of the corporations and limited partnerships mentioned or embraced in class first of said agreement should be transferred and vested in the said several Standard Oil Companies; that all of the property, assets, and business in or of each particular State should be transferred to and vested in the Standard Oil Company of that particular State, and the directors and managers of each and all of the several corporations and associations mentioned in class first were authorized and directed to sell, assign, transfer, and convey, and make over to the Standard Oil Company or Companies of the proper State or States, as soon as said corporations were organized and ready to receive the same, all the property, real and personal, assets and business of said corporations or associations; and whereas it is not deemed expedient that all of the companies and associations mentioned should transfer their property to the said Standard Oil Companies at the present time, and in case of some companies and associations it may never be deemed expedient that the said transfer should be made, and said companies and associations go out of existence; and whereas it is deemed advisable that a discretionary power should be vested in the trustees as to when such transfer or transfers should take place, if at all: Now, it is hereby mutually agreed between the parties to the said trust agreement, and as supplementary thereto, that the trustees named in the said agreement and their successors shall have the power and authority to decide what companies shall convey their property as in said agreement contemplated, and when the said sales and transfers shall take place, if at all, and until said trustees shall so decide, each of said companies shall remain in existence, and retain its property and business, and the trustees shall hold the stocks thereof in trust, as in said agreement provided. In the exercise of said discretion the trustees shall act by a majority of their number as provided in said trust agreement. All portions of said trust agreement relating to this subject shall be considered so changed as to be in harmony with this supplemental agreement.

In witness whereof, the said parties have subscribed this agreement this 4th day of January, 1882..

(Duly signed by the same parties.)

~~association~~
Combination

Alliances - surrender part of rights. { association give away few rights
combination " " more than dem.
Mergers - surrends all rights

Cooperative association
Trade statistics

selling combination

Combinations —

Limiting combinations
Sharing " - profits production {

tation of Territory, Price, & Production Combinations
Sharing combination is prob.

Trustee device stands on Trustee
Holding Co or charter.

THE HOLDING CORPORATION - I.

Contents

The particular form of organization adopted for the purpose of administering the business affairs of any industrial enterprise is determined chiefly by the character of the business, the social and moral development of the parties interested, and finally, the legal regulations of the country within which the operations are conducted. Thus, so long as individual workmen employed only hand tools, small shops owned and directly managed by the leading artisans were universal. When, late in the eighteenth century, the inventions of Hargreaves, Arkwright and Crompton revolutionized the methods of manufacturing not only in the textile industry but in other lines, and indicated the lines of future progress of all important branches of industry, the organization of business establishments slowly but surely went through the changes necessary for their adaptation to the new economic and industrial conditions. Consequently, the partnership partially supplanted the individual proprietor, and later the corporation, first used on a considerable scale by the Roman administrators for public purposes, after being practically abandoned for more than a thousand years, owing to the primitive conditions in industry and the low commercial standards in business, was revived in the most advanced industrial nations and has proved so well adapted to modern conditions that it has succeeded in almost entirely supplanting both the individual proprietor and the partnership in every field where massed capital and labor has been demanded by modern conditions of trade and industry.

The transformation in industrial methods and in the administration of industrial establishments caused by the invention of machinery and the development of steam as a motive power was followed by a second stage in industrial revolution, in which independent industrial establishments of immense economic power were brought into close quarters, and large rewards were offered the victors in the struggle, provided they would fight to the finish. This second stage was the result of the cheap and rapid communication through the railroad, telegraph, and telephone. The normal effects of the introduction of cheap transportation would undoubtedly have been far-reaching enough to cause a marked readjustment of the relations of existing industrial units. But under the influence of the laissez-faire ideals, so powerful during the past century, the railroad, the chief instrument in bringing about the second transition, were encouraged to compete with each other by law, by public opinion, and by financial success; and in so doing they necessarily introduced abnormal conditions into the relationships between existing industrial establishments, which gradually forced the larger and more fully developed establishments to enter into open warfare with every other establishment of its own kind. This condition of affairs began to have its necessary effect in the decade immediately

preceding the Civil War; during this period the small plants in the capitalistic industries were rapidly abandoned, and the larger plants were improved in quality and enlarged in size to meet the unusual conditions forced upon them by the operation of the law of decreasing cost of manufacture and the introduction of railroad rates based upon what the traffic would bear. The Civil War served to delay the movement for at least ten years; by 1870, however, the movement was again in full force and manifested itself particularly in those industries where cheap railroad rates brought manufacturers naturally separated by distance into close business proximity, or where manufacturing was localized in some particular section of the country owing to natural conditions. The inevitable results of such conditions were perceived earlier by the managers of railroads than by the managers of manufacturing establishments. Consequently, even before the Civil War, the former began the extension of their lines for the purpose of facilitating through traffic, and at the same time were busy securing control of competing lines in order to prevent traffic wars.

The first movement was fostered by the States in the interest of economy and to enable their own manufacturers to enter into competition with those of other States. The latter movement was effected by the railroad managers themselves, in spite of the opposition of public opinion and public law, by every device known to an ingenious and inventive race. The immediate and necessary effect of the extension and the consolidation of the railroads was to give to manufacturers who could offer a larger tonnage an advantage over their smaller and less advantageously situated neighbors. Where these conditions were allowed to work out the results, the smaller plants were abandoned after a struggle more or less protracted, and the larger ones increased their capacity to fill the demands of the market. Thus the process was not only destructive to the weaker plants, but costly to the larger ones; for the former did not abandon the field without a struggle, during which low prices and unusual expenses made it impossible in many cases to realize the cost production, much less the ordinary rate of profits.

What then was the remedy for such conditions? During the last half century the answer has been worked out, partially at least, in every country where modern methods of manufacturing and modern means of transportation have been introduced on a large scale. The answer is: Devise and establish a system of law and order among industrial establishments similar to that which governments have ordained to perpetuate, adjust and harmonize the relations and interests of individual citizens. In working out the details of this problem, viz., the organization of industrial establishments into societies of more or less permanence, three principal forms of union have been evolved. These are: the combination, the trust, and the holding corporation.

I. The combination is simply an agreement or contract between independent industrial establishments which limits their former independence in the particulars covered by the contract, but leaves each free in every other respect. Thus a group of manufacturers agree not to sell below a certain price for a period of one year; this is a price combination. Or they agree to sell only within a certain geographical area; this is a territorial combination. Or, to manufacture only a certain quantity during a given period; this is a production combination. Or, to share sales according to a prearranged schedule; this is a sales combination. Or, to divide the profits in a similar way; this is a profit-sharing combination.

Combinations of the several kinds above described sprang up in the United States during the later sixties and were the characteristic feature of the industrial development of the period from 1872 to 1882. During the seventies, combinations were formed in many important industries in Germany and to a much smaller extent in those of England, France, and the more advanced countries of the Continent. From the very beginning in the United States these combinations were generally held to be illegal at common law, and by 1890 the common law had been supplemented in a majority of the States by statutes prohibiting the formation of combinations and providing severe penalties for those found to be parties to such organizations. Consequently, while in the various European countries, especially in Germany, where combinations were enforceable at law, consolidations in this form have continued to flourish to the present time. They were generally abandoned in the United States in the eighties and a new and stronger form of union devised to take their place in the industrial system.

II. In the American system the trust was the direct successorof the combination. It is said to have originated in the fertile brain of Mr. S. C. T. Dodd of the Standard Oil Company, although the facts in the case indicate that it was a gradual evolution rather than the invention of any one man. In fact, the trust was the union of three ideas, all of which were in actual operation at the time the trust first appeared. First, the combination of industrial enterprises; second, the development of a common body of stockholders in a group of related corporations, and third, the common law trust.

The first of these ideas had developed naturally enough from the existing conditions, but was found impracticable in the United States, owing to public disapproval enforced through the common and statute laws. The second was, as appears from the investigations of the United States government, a characteristic of the petroleum industry in the seventies, resulting in the informal trust of 1879. The informal trust of 1879, combined with the two preceding ideas, had all the essential elements of the trust of January 1, 1882, invented by Mr. Dodd especially for the Standard Oil interests.

The trust consisted in simply exchanging stock in a group of related corporations for trust certificates issued by a board of trustees acting for the combination in question. The trustees, being elected by the holders of the trust certificates, were of course responsible to them for the general management of the trust. Their important work, however, consisted in the election of directors for the companies whose stock constituted the sole assets of the trust, and through such directors to operate and control the companies in a harmonious consolidation.

The trust possessed all the advantages of the combination and in addition certain other economies which the combination, on account of its form, could never attain. It could regulate and maintain prices, it could determine and thus limit the output, it could divide territory if such a policy was deemed advisable, it could distribute the work among the several factories in such a way as to secure the lowest cost of production, and by virtue of its organization, the profits were shared in accordance with the value of the several properties consolidated into the trust. In addition to these advantages, all of which might be secured through the combination, the trust made it possible to secure the economies of central-

ized management and concentrated production. Since the trustees controlled the election of the directors in the several constituent companies, they could through such directors consolidate the administration by appointing a general sales agent, a generalmanager of all manufacturing plants, a general auditor, and a general treasurer. While the accounts of the several companies must be kept separate, standard methods in all departments could be introduced. The comparative method could thus be installed and the efficiency of the various departments tested. Production could be concentrated in the plants where the cost was found to be the lowest, and buildings and sites not so well adapted for manufacturing could be sold for other purposes or abandoned altogether. In short, the trust was an economic instrument capable of securing all the advantages possible under consolidated management.

The success of the Standard Oil Trust was so pronounced that a number of the larger combinations followed its example and transformed their combinations into trusts. That this form of organization was not more widely adopted was due to several causes, among which the following are the more important:

1. The difficulty of adjusting the valuation of the several properties transferred to the trust in such a way as to meet the approval of the interested parties, and

2. The decision of the New York Court of Appeals and the Supreme Court of Ohio to the effect that the trust was an illegal form of combination.

1. Since the trust agreement was in effect a permanent consolidation of property rights of the parties to it, the valuation put upon the properties of the several corporations united was of the utmost importance. The valuation determined the voting rights of the holders of trust certificates and the percentage of earnings in the form of dividends which accrued to each of the members. Unless an agreement could be reached as to the comparative value of the several properties, the plans looking toward the formation of a trust in any industry must necessarily be abandoned. Moreover, during the period in which the trusts were being formed, the science of accounting in this country was in its infancy. Consequently, while as in the Standard Oil Trust Agreement, it was generally agreed that the property of each corporation should be put in at a "fair" valuation, such valuation was reached as the result of a bargain in which the weaker plants took what was offered them or stayed out of the agreement at their peril.

This difficulty was sufficiently great to prevent most combinations from adopting the trust form during the period within which it was legally permissible.

2. On the sixteenth of April, 1888, the attorney-general of the State of New York was petitioned to bring suit against the Sugar Refineries Company and the North River Sugar Refining Company, one of the constituent companies of the Sugar Trust. In the petition it was contended that the Sugar Trust had assumed all the ordinary powers and privileges of a corporation without possessing a charter, and in addition had gained a monopoly in the manufacture and sale of sugar; that the North River Sugar Refining Company had entered into an agreement with certain other sugar refining companies named in the petition, and in accordance with its terms had surrendered its stock to the Sugar Trust. For the defence it was contended that

the stockholders in surrendering their shares to the board of trustees were acting for themselves individually, and that therefore the corporation could not be held for their acts. In addition it was also argued that even if the action of the stockholders could be imputed to the company, such act was legal.

In May, 1890, a month preceding the final decision in the Sugar Trust case, a similar action was brought by the attorney-general of Ohio in the Supreme Court of that State against the Standard Oil Company of Ohio, praying for the forfeiture of that corporation's charter on substantially similar grounds. In this case the Standard Oil Company defended its acts along the same lines, and in addition on the ground that even if its acts were held to be illegal, the statute of limitations afforded protection to the corporation.

Each of these cases raised the same fundamental questions of economic policy, namely, are the acts of the individual members of a corporation, when conducted with substantial unanimity and with the same end in view, so that the business and property of the corporation is affected in substantially the same way as though the action had been a formal one by vote of the stockholders and directors, the acts of the corporation itself? Secondly, are corporations chartered for specific purposes permitted under the law to enter into partnership arrangements with other similar corporations? and, thirdly, when the union of corporations under the trust form brings about a condition such that competition is partially or completely destroyed, and the public thus deprived of its benefits, is any relief provided under common or statute law? In each case the defendants admitted that the trust agreement had been entered into; that the parties to it were the stockholders of the several corporations; that the purpose was to effect economies and in general to protect the interest of the several members. It was contended that a corporation is a distinct legal person; that it could be bound only by action taken in the regular way--that is, through a vote of the stockholders or directors; that no such agreement had been entered into by the corporations against which the suit was brought; that the stock had been transferred by the individual stockholders to the trustees in the regular way, and that the corporations had no power or authority to prevent such transfers even had they so desired; also, that the corporate existence was maintained, the corporations were performing their duties in the ordinary way, and the earnings were being divided among the legal holders of stock, as was required by law. Consequently, it was urged that the corporations as such were entirely innocent of the acts charged against them and the suit should be dismissed. In behalf of the government it was argued that an agreement is illegal and void if it creates a partnership between corporations, or if its probable operation and effect is to create a substantial monopoly, and that when a corporation submits to the domination of an agency unknown to the statutes, or takes part in an agreement injurious to the public, it forfeits its chartered rights. Finally, that each corporation against which suit was brought had become a party to such an agreement through the practically unanimous action of the individual members of the various corporations.

The reasoning of the judges in the two cases followed the same general lines. The charter was granted to the signers of the original certificate of incorporation. The shareholders are their successors and representatives. As their successors and representatives they owe a duty to the State to maintain the integrity of the corporation and to see that it is devoted to uses not contrary to the public policy of the State. In the words of the court: "The state gave the franchise, the charter, not to the impalpable, in-

[illegible] that even if the action of the [illegible] company, such act was legal.

[illegible] 1890, a month preceding the final decision in the Sugar [illegible], a similar action was brought by the attorney-general of [illegible] Supreme Court of that State against the Standard Oil [illegible] Ohio, praying for the dissolution of that corporation's [illegible] substantially similar grounds. In this case the Standard [illegible] contended its acts along the same lines, and in addition [illegible] that even if its acts were held to be illegal, the [illegible]

[illegible] of these cases raised the same fundamental questions of [illegible] law, namely, are the rights of the individual [illegible], when combined with substantial unanimity and with [illegible] and in view, so that the business and property of the corpor- [illegible] is affected in substantially the same way as through the action [illegible] a firm, one by vote of the stockholders and directors, the [illegible] the corporation itself? Secondly, are corporations chartered [illegible] purposes permitted under the law to enter into partner- [illegible] with other similar corporations? and, thirdly, [illegible] union of corporations under the trust form bring about a [illegible] such that competition is partially or completely destroyed, [illegible] the benefit of its benefits, is any relief provided [illegible] or statute law? In each case the defendants admitted [illegible] such agreement had been entered into; that the parties [illegible] the stockholders of the several corporations; that the [illegible] to effect economies and in general to protect the inter- [illegible] several members. It was contended that a corporation is [illegible] that it could be bound only by action [illegible] regular way--that is, through a vote of the stockholders [illegible] that no such agreement had been entered into by the [illegible] against which the suit was brought; that the stock had [illegible] by the individual stockholders to the trustees [illegible] way, and that the corporations had no power or auth- [illegible] such transfers even had they so desired; also, that [illegible]

[illegible] in the ordinary way, and the earnings were [illegible] the legal holders of stock, as was required by [illegible] it was urged that the corporations as such were [illegible] of the acts charged against them and the suit [illegible] ed. In behalf of the government it was argued [illegible] illegal and void if it creates a monopoly [illegible] or if its probable operation and effect is to [illegible] monopoly, and that when a corporation submits [illegible] an agency unknown to the statutes, or takes [illegible] injurious to the public, it forfeits its [illegible] Finally, that each corporation against which suit [illegible] a party to such an agreement through the [illegible] action of the individual members of the cor-

[illegible] two cases followed the same [illegible] to the signers of the [illegible] The stockholders are their [illegible] successors and repre- [illegible] to substitute the industry

tangible and almost nebulous fiction of our thought, but to the corporators, the individuals, the acting and living men, to be used by them, to redound to their benefit, to strengthen their hands and add energy to their capital. If it is taken away, it is taken from them as individuals and corporators, and the legal fiction disappears. The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct; and when they all act collectively as an aggregate body, without the least exception, and so acting reach results and accomplish purposes clearly corporate in their character and affecting the independence, the utility, of the corporation itself, we cannot hesitate to conclude that this has been corporate conduct which the state may review, and not to be defeated by the assumed innocence of convenient fiction."

The trust, having been declared illegal by the highest court, both in New York and Ohio, was abandoned by the several organizations that had been operating under this form of union. The Sugar Trust was converted into a corporation with a New Jersey charter, trust certificates were exchanged for shares in this corporation, the new company purchased the assets of the several corporations which united to form the trust, and the several constituent corporations were duly dissolved, the proceeds of the sale of the personal property being divided among the various shareholders. The Standard Oil Trust adopted a different plan. The trust form was of course abandoned, but instead of forming a central corporation, the holders of trust certificates were given in exchange their proportionate part in the shares of the several Standard Oil corporations which made up the original trust. As a result the Standard Oil properties were still united by the tie of a common body of stockholders.

Neither the organization adopted by the Sugar Trust nor that devised by the Standard Oil Company possessed the characteristics necessarily demanded for a permanent form of consolidation. The former, namely, the dissolution of the subsidiary corporations and the sale of the real property and other assets to the central corporation, would in many instances involve the surrender of valuable franchises and other rights inseparably connected with the corporate existence of the subsidiary companies. The more valuable such rights the greater the loss incurred by the adoption of the absolute merger. The latter form, the transference of equal fractional parts of the stock in many small corporations to the same group of stockholders, while obviating the difficulty imposed by the first method, made it probable that the consolidation would be destroyed sooner or later by the sale of stock to outside interests. What was demanded was a form of organization that insured the perpetuity of the organization, the permanent possession of the franchises and good will of the subsidiary corporations and, in addition, one that not only permitted complete control of the industry but in addition favored the inauguration of all possible economies of concentration in administration and manufacturing. Such an organization was found in the holding corporation.

III. The holding corporation was not at this time an unknown institution. It was first used in the modest way by the railroads, and later adopted on a larger scale by the railroad and telegraph companies; finally, in its complete form, it became the direct successor of the trust and the chief instrument of public service and general industrial corporations for the permanent consolidation of entire industrial groups.

[illegible] ration of our [illegible], but to the [illegible] the nation and living man, to be used [illegible] to their right I. If it is taken away, it is taken [illegible] individuals and corporations, and the long tradition [illegible] the benefit is theirs, the punishment is theirs. [illegible] and are depend upon their conduct; and upon they all [illegible] by an aggregate body, without the least exception.

[illegible] character and affecting the independence, the utility [illegible] corporation theory, we cannot possibly to conclude that [illegible] corporate conduct within the scope, may review, and [illegible]

[illegible], having been condemned illegal by the highest court, [illegible] York and Ohio, was abandoned by the several organizations that had been operating under this form of union. The Sugar Trust converted into a corporation with a New Jersey charter, [illegible] officers were empowered for service in this corporation. [illegible] company purchased the assets of the several corporations [illegible] to form the trust, and the never [illegible] corporation [illegible] duly dissolved, the assets of the [illegible] being divided among the various stockholders. The Sugar Trust adopted a different plan. The trust form was [illegible] adopted, but instead of forming a single corporation, [illegible] of trust certificates were issued to the stockholders, [illegible] the part in the owners of the several standard Oil companies [illegible] the original trust. As a result the Standard Oil [illegible] corporation was still united by the tie of a common body [illegible].

The organization adopted by the Sugar Trust for that [illegible] the Standard Oil Company possessed the characteristics [illegible] intended for a permanent form of combination. The [illegible] by the dissolution of the quasi-military corporations [illegible] of the real property and other assets to the central [illegible] would in many instances involve the surrender of [illegible] and other rights inappropriately connected with the [illegible] absence of the subsidiary companies. The more [illegible] the market the loss incurred by the adoption [illegible] trust form. The transference of other [illegible] of the stock in many small corporations to the [illegible] trust, made it possible that the conditions would [illegible] later by the sale of stock to small investors [illegible] or later by the sale of stock to small investors [illegible] was a form of organization that insured [illegible] of the organization, the permanent possession of the [illegible] will of the subsidiary corporations and. in [illegible] not only, secured complete control of the industry [illegible] the innumerables of all possible economies [illegible] administration and manufacturing. Soon as [illegible] in the holding corporation.

[illegible] corporation was not as [illegible] used in the modest way by the railroads. [illegible] by the railroad and [illegible] instrument of public service [illegible] for the permanent combination-

As early as 1832, the Baltimore & Ohio Railroad Company was authorized by the State of Maryland to subscribe to such portion of the stock of the Washington Branch Road as remained unsubscribed after the books had been opened thirty days: to borrow money to pay the installments as they came due, and to pledge the property and funds of the railroad company for this purpose, provided a majority of the stockholders should assent. A meeting of the stockholders was duly called and the purchase of stock in the Washington Branch Road authorized by a large majority, in due course of time the Baltimore & Ohio became the owner of 9,388 shares of the Washington Branch Road, or somewhat less than two-thirds of the total issue.

Again, in 1846, the Baltimore & Ohio invested in the stock of a subsidiary railroad by subscribing for seven hundred shares, par value $50, of the Pittsburg & Connellsville, an important lateral road. This method of controlling railroad lines naturally connected with the main system has been consistently followed by the Baltimore & Ohio until the present time, when it owns stock in over eighty different corporations, amount in value to nearly fifty millions of dollars, or about one-tenth of its entire assets.

The Pennsylvania Railroad Company entered upon its distinguished career as a stockholding corporation as early as 1853. In that year, in order to control the western connections which it desired to assist, this company secured the passage of a special act by the Pennsylvania Legislature, authorizing it to subscribe to the capital stock or guarantee the bonds of other companies, to the extent of fifteen per cent. of its own paid up capital stock. Under the authority thus granted, the Pennsylvania exchanged stock with the Marietta & Cincinnati to the extent of $650,000 par value, with the Maysville & Big Sandy to the extent of $100,000 par value, with the Ohio & Indiana to the extent of $300,000 par value, with the Ohio & Pennsylvania to a like amount; and with the Springfield, Mt. Vernon & Pittsburg to the extent of $100,000.

Although investments in the stock of several of the above roads proved a failure from a strictly financial point of view and were later charged to profit and loss, the policy inaugurated by the company was pursued with great vigor during next two decades, and finally led to the creation of the Pennsylvania Company, the first pure holding corporation which the writer has been able thus far to discover. The Pennsylvania Company was organized by a special act of the Pennsylvania Legislature on April 7, 1870, for the purpose of centralizing and controlling the stocks in western railroads owned by the Pennsylvania Railroad Company and allied interests, and in addition, for providing a more convenient method of managing the vast network of lines from Pittsburg to Chicago and St. Louis.

The act of incorporation, given in full in the "Corporate History," etc., referred to in footnote 21, in addition to the usual clause authorizing the railroad company to carry on its normal function of constructing railroads and carrying passengers and freight, included the following: "The company hereby created shall also have the power to make purchases and sales for investments in the bonds and securities of other companies." It was thought that through the instrumentality of the Pennsylvania Company it would be possible to obtain large economies by transferring the rolling stock of one railroad to another, according as the traffic conditions of the various lines demanded. The Pennsylvania Railroad Company thus be-

came substantially the sole owner of the capital stock of the Pennsylvania Company, which in turn owned a majority interest in the capital stock of the so-called Pennsylvania lines west of Pittsburg. In 1879 the total assets of the Pennsylvania Company were a little more than twenty-five millions, and of this amount over fifteen millions was represented by securities in western lines. Twenty years later the assets had increased to over sixty-six millions, and the value of the securities owned was placed at over forty millions of dollars, representing about 80 per cent. of the fixed assets of the company.

The Pennsylvania Railroad Company has continued to extend its system, largely through the purchase of securities in the companies it desires to control, even up to the present time. Its assets in other companies at various selected dates are given as follows:

Pennsylvania Railroad Company, Securities Owned.

Year	Cost	Par Value	Total Assets.
1866	$ 6,243,892		$ 45,850,796
1874	52,692,419	$ 73,594,440	140,725,636
1885	100,092,740	133,108,746	207,891,590
1899	120,362,495	176,254,489	284,756,979

The Chicago & Northwestern Railway Company was enlarged June 2, 1864, by a consolidation of the existing Chicago & Northwestern Railway and the Galena & Chicago Union Railroad Company. This consolidation was effected, under authority granted by the States of Illinois, Wisconsin and Michigan, by an exchange of the stock of the Chicago & Northwestern Railway Company for the stock of the Galena & Chicago Union Railroad Company. By this act the Chicago & Northwestern Railway Company became a holding company for the Galena properties, although later the stock of the Galena company was entirely converted into the Chicago & Northwestern stock and its corporate existence terminated, the properties long completely merged.

Previous to this consolidation the Galena company was a stockholding corporation to a limited extent. In 1854 the Beloit & Madison, then in process of construction, failed, was reorganized, and then leased to the Galena company which, after the reorganization, held a majority of its stock. Just before the consolidation with the Galena company, the directors of the original Chicago & Northwestern Railway Company were authorized by the stockholders to consolidate with the Peninsula Railroad Company, provided acceptable terms could be arranged. The negotiations, although delayed until after the union of the Northwestern and the Galena railroads, were finally successful, and the consolidation was accomplished by exchange of stock, one-half share of common and one-half share of preferred stock in the new Northwestern being given for each share of the Peninsula Railroad Company. Soon after the consolidation, the new Chicago & Northwestern Railway Company found it desirable to secure control of the Chicago & Milwaukee, "the only remaining line in competition with the roads of this company." Since it was feared that public knowledge of the project would prevent its successful consummation, the directors assumed responsibility for the movement without securing authority from the stockholders in advance. The consolidation was effected by the exchange of stock of the Chicago & Northwestern Railway Company for that of the Chicago & Milwaukee, $1,372,000 of the preferred stock being given for 12,741½ shares of the Chicago & Milwaukee Company, a controlling interest

in the stock of the subsidiary company. Thus even before the Civil War the Chicago & Northwestern Railway Company learned the use of the stockholding method of controlling corporations and was making use of this device as occasion presented. At this time its total assets were about fortymillions of dollars, and of this over one and one-third millions, or over 3 per cent., was in securities in other companies. Late in the sixties it entered upon a new policy, namely, the acquisition of the entire capital liabilities of its subsidiary lines, followed by a complete consolidation of the physical properties. At the present time it is a large stockholder in the Chicago, St. Paul, Minneapolis & Omaha, and a few of its small tributary lines, and has recently become a small stockholder in the Union Pacific.

Among public service corporations the Western Union Telegraph Company seems to have used the stockholding method of controlling rel ated and competitive lines earliest and with the greatest success. In January, 1864, this company arranged to exchange $1,277,210 of its own stock for $1,000,000 in par value of the stock of the Pacific Telegraph Company, for the purpose of controlling the telegraph business from Omaha to San Francisco. Early in the same year it also issued $600,000 additional stock to acquire the stock in the New York, Albany & Buffalo Company, and $146,500 to acquire the New York & Washington Printing Telegraph Company. Between October, 1865, and July, 1869, the stock of the Western Union was increased from a little over twenty-one million to approximatelyforty millions, par value, and practically all of the new issues were used to acquire stock in some ten or a dozen different telegraph companies. In addition the company was purchasing stock in other companies out of its own earnings. In 1868, $125,644.27 was thus appropriated, and in 1869 $145,170.60 was used in the same way. During this period the company was also acquiring the stock of other telegraph companies by issuing its own bonds and exchanging the same for the stock in such companies. The company was also purchasing its own outstanding stock in the open market with surplus earnings and using such stock, held in the treasury, to exchange with the owners of stock of rival companies.

The Western Union pursued this policy consistently during the next ten years and finally, in 1881, succeeded in gaining control of its most important competitors. In that year the stock of the Western Union was increased to eighty millions of dollars. The new issue was used as follows: Fifteen millions was exchanged for the stock and bonds of the American Union Telegraph Company , a stock dividend of 38¼ per cent. distributed to its own stockholders, and the remainder exchanged for the stock of the Atlantic & Pacific Telegraph Company, its leading rival, at a ratio of 3 to 5. In 1882 the Western Union owned stock, and generally a majority interest, in over thirty companies, a considerable number of which it leased and operated directly.

In 1887 the Western Union gained control of another rival, the Baltimore & Ohio Telegraph Company, and issued five million dollars of its own stock in exchange therefor. At the present time it controls about thirty companies by the stock ownership method. The latest development comes,however, with the announcement that the practical control of the Western Union itself has been secured by the American Telephone and Telegraph Company, through the method of stock ownership so vigorously and successfully used by the Western Union in earlier days, namely, the purchase of its stock in the open market and the exchange of the same for that of the holding company.

[illegible] Company learned the use of [illegible] corporations had was making [illegible] revenue. At this time its annual [illegible] millions of dollars, and of this over one [illegible] or over 3 per cent., was in securities in [illegible] In the addition it earned upon a new policy, [illegible] of the entire capital liability of the [illegible] followed by a complete consolidation of the physical [illegible] At the present time it is a large stockholder in the [illegible] Minneapolis & Omaha, and a few of the small [illegible] and has recently become a small stockholder in the [illegible]

[illegible] public service corporations the Western Union Telegraph [illegible] to have been the acquisition of controlling [illegible] a controversy with the [illegible] business. [illegible] 1884, this company attempted to exchange $1,377,410 of [illegible] stock for $1,000,000 in par value of the stock of the Pacific [illegible] Company, for the purpose of controlling the telegraph [illegible] from Omaha to San Francisco. Early in the same year it [illegible] $500,000 additional stock to acquire the stock in the [illegible] Albany & Buffalo Company, and $145,500 to acquire the [illegible] Printing Telegraph Company. Between October [illegible] 1887, the stock of the Western Union was increased [illegible] over twenty-one million to acquire twenty million, [illegible] partly with the new issues used to acquire [illegible] on of a dozen different telegraph companies. In [illegible] property was acquired stock in other companies out [illegible] type. In 1888, $125,000,000 was thus appropriated [illegible] $10,000,000 was used in this same way. During this [illegible] was also acquiring the stock of telephone [illegible] its own bonds and exchanging the same for the stock in [illegible] The company was also purchasing its own outstanding [illegible] upon market with surplus earnings and using such [illegible] in the treasury, to exchange with the owners of [illegible] companies.

[illegible] Western Union passed into a [illegible] period. [illegible] years from liability, in 1881, succeeded in gaining control [illegible] important competition. In that year the stock of the [illegible] was increased to eighty millions of dollars. The new [illegible] as follows: Fifteen millions was exchanged for the [illegible] of the American Union Telegraph Company, a stock [illegible] per cent, distributed to its own stockholders, [illegible] issued for the stock of the Atlantic & Pacific [illegible] leading rival, at a ratio of 3 to 2. In [illegible] companies, a considerable number of which it leased [illegible] roots.

[illegible] gained control of another rival, the [illegible] and issued five million dollars [illegible] stock. At the moment this it con- [illegible] the stock ownership method. The [illegible] with the announcement that the [illegible] been secured by [illegible] between the bottom of [illegible] by the Western [illegible] stock in the

The stockholding method of controlling subsidiary corporations was thus not only well known in theory to the financiers of the early nineties, but was in actual use on a large scale when the courts declared the trust illegal and ordered the dissolution of the consolidations organized under that particular form. At this juncture the holding corporation would undoubtedly have been substituted for the trust but for the fact that express authority must be obtained by a special act of some legislature before such corporation could be formed and take over the stock of existing corporations. That is, a corporation could purchase and hold stock of other corporations only when expressly authorized to do so by the statute or when such power could be implied as incidental to powers already granted. Since the latter clause was strictly construed by the courts, practically all corporations holding stock in other corporations did so by virtue of some special act. In the year 1889, however, this obstacle to the general use of the holding corporation was removed. The State of New Jersey amended her general corporation act by the addition of a clause providing that corporations chartered under the laws of that State, with certain exceptions, might hold stock in other corporations, wherever such power was deemed desirable by the board of directors and the right to do so was expressly stated in the articles of incorporation. The opportunity furnished by the New Jersey amendment was not appreciated at once. Neither the sugar trust nor the oil trust officials seem to have given the holding corporation any attention at the time when the trust form was held illegal. Soon after this, however, the sugar company purchased the stock of the Philadelphia refineries, thus practically monopolizing for the time being the refining of sugar in the United States. Suit was brought under the Sherman Anti-Trust Act in the Circuit Court of the United States for the Eastern District of Pennsylvania for the purpose of compelling the restitution of the shares and the dissolution of the holding corporation. The case was appealed to the Supreme Court, where it was finally decided that this form of organization was legal under the Anti-Trust Act; that since the holding company was formed to consolidate the manufacture of sugar, and since the business of selling sugar was merely an incident to its manufacture, the organization was not formed for the purpose of restraining trade among the several States or with foreign nations. As a result of this decision the holding corporation immediately superseded all other forms for the organization of consolidations and since that time has had no rival in its field.

In its external structure the holding corporation is identical with that of the ordinary corporation. It is composed of a group of individuals who own stock, elect directors, draw dividends, and in general perform such other duties and possess such other rights as usually belong to shareholders in a corporation. In its internal structure it differs in certain important respects from the usual type. In the first place, its property account is composed of shares of stock in one or more corporations, varying in amount from a minority interest in one small corporation to a majority interest in many large ones. Consequently, since the assets consist of shares in other corporations, the duties of the directors are limited to voting such shares at the meetings of the several corporations, receiving dividends from the subsidiary corporations, and declaring such dividends to its own stockholders as the revenue from its shares of stock may warrant.

And, thirdly, in its fully developed form it is an organization by which a considerable number of related manufacturing plants are bound together into a permanent union. Its function is, then, to unite manufacturing corporations, just as the ordinary corporation unites individuals into manufacturing establishments.

As previously stated, a holding corporation may own any amount of securities, ranging from a minority interest in one corporation to a majority interest in a group of related industrial establishments. The first type has no economic advantage and therefore is seldom found, except as a step toward the formation of the second type. The latter form of organization, while permitting the continued existence of all the subordinate corporations, insures under normal conditions their harmonious administration and operation through the control exercised by the central or holding corporation. For it will be observed that since the holding company owns a majority of the stock in each of the subsidiary corporations, the directors of the central corporation are able to elect the directors of the controlled corporations and through their control of the directorates, are able to administer each of the subordinate corporations as though the several properties were owned directly.

This is the condition that normally exists. Suppose, however, that the directors of one of the subordinate corporations having been formally elected and installed in office, differ radically with the directorate of the holding corporation on matters of importance affecting the corporation over which they are placed in authority. Which line of policy will prevail? For the term of their office, the directors of the subordinate corporation, being legally in control, are in a position to carry out their own policies, within the restrictions fixed by the corporation law under which they are acting, notwithstanding the wishes of the directors of the holding company. When their term of office expires, however, the central board of directors, having the control of the election through the right of voting the shares owned by the holding company, are in every case able to depose each of the rebellious directors and substitute others who to them seem likely to remain subservient to the interests of the central corporation. Moreover, it is a common, if not the usual thing, for the directorate of the central or holding company to place enough of their own members upon the boards of the several corporations controlled, to make even the above conditions impossible in fact, although entirely possible in theory. Under normal conditions, then, the subordinate corporations are in the long run bound to be operated in the interests of the holding corporation, subject of course to such restrictions as may be imposed by law or custom in the interests of the minority stockholders.

However, conditions may exist, such for example as those present in the case of the United States Shipbuilding Company, which not only prevent the holding corporation from exercising its usual functions in the accustomed way, but as a matter of fact render its control impracticable in operation. This condition exists whenever any one of the subordinate corporations is larger in voting strength than all the others combined, or in fact so much larger than any of the others that it is enabled to dominate the policy of the consolidation in the interests of its own shareholders. In the United States Shipbuilding case, the stockholders of the Bethlehem Steel Company were given in exchange for their shares a majority of the votes--that is, shares and income bonds with voting powers--in the holding corporation. The Bethlehem Steel

Company interests, seeing that the United States Shipbuilding Company had been so heavily bonded that its failure was preordained, withheld dividends and applied its earnings to improvements in the Bethlehem plant. Those formerly interested in the smaller companies of the consolidation were powerless to prevent this action on the part of the Bethlehem Steel Company directorate, since the Bethlehem interests were in the majority in the holding company and, naturally enough, controlled not only the Bethlehem company, but all others in the United States Shipbuilding Company, in the interest of that corporation. In this case the outcome was exactly what had been forseen by the Bethlehem company. The United States Shipbuilding Company failed, a receiver was appointed, and in the reorganization which followed the Bethlehem Steel Company which, although in form a subsidiary corporation, had in reality been in control of the entire consolidation, took its proper place at the head of the organization. The companies that in the original shipbuilding consolidation had been its copartners now became its subjects, and consequently the recipients of its most careful consideration. It is evident, both from theoretical considerations and from the experience of this and other cases, that the holding corporation in its normal and natural form is a convenient method of consolidating interests naturally allied; and further, that its control over the subsidiary corporations, while indirect, is still efficient and effective. But when one of the subsidiary corporations is so large as to control the central company, the organization is perverted in form and will be followed by internal dissension and disaster, until the organization is transformed into the normal type with a corporation which actually controls placed in the commanding position and the subsidiary corporations in their normal positions as subjects of the central or holding corporation.

Maurice H. Robinson.

The Holding Corporation - II.

Contents.

The holding corporation, being formed not for the purpose of operating factories, stores and railways, but controlling them in its own interest, owns in its ultimate form a majority of the voting shares in all the corporations in which it is financially interested. These subordinate corporations are selected by those administering the affairs of the holding corporation not indiscriminately, but with certain definite economic ends in view. Since there is no direct benefit to be gained from the united management of factories, mercantile establishments, and railways having no economic relationship, unions of this sort under a holding company seldom if ever exist. The holding corporation is used to form integrations, concentrations, and consolidations combining both of these forms of union. The holding corporation is peculiarly adapted to the promotion of integrations, since in this form of union the consolida-

tion of their administration and not of the operating plants is the object sought. It harmonizes the economic relationships of the establishments without disturbing the physical personality of any of them.

The holding corporation is equally well fitted to furnish a form of union between establishments of the same general character. When such plants are situated so far apart that the fields of operations do not overlap, they are not of course competing in the sale of a common product. In such cases, however, they are likely to find themselves purchasers of materials in the common market, and union under a holding corporation removes this source of economic conflict. Moreover, since the establishments are of the same general character, the administration may be centralized and comparative tests introduced for the purpose of stimulating efficiency with its attendant economy. Examples of this type of consolidation effected through the holding corporation are most frequently found in the public service field, such as gas and electric light companies and to a certain extent street car systems located in several different cities.

When the subsidiary corporations are direct competitors before the formation of the consolidation, the holding corporation is the direct successor of the original trust and has to a quite remarkable extent perpetuated its characteristics and inherited in popular language and thought its name. The holding corporation has in addition certain peculiar features which render it a more efficient tool in the hands of the promoting class for the purpose of uniting a group of competitive establishments.

In the first place, a holding corporation consolidating an entire industrial group may in certain cases be formed without consultation with the owners of the separate and competing establishments and without their mutual agreement upon the terms of union. This may be accomplished by purchasing in the open market a controlling interest in the stock of each of the companies which it is desired to consolidate, the incorporation of the holding company, an exchange of the stock of the subsidiary companies for stock in the holding company on terms arranged by the common owners of both kinds of securities, and the subsequent sale of such part of the holding company's stock as may be necessary to secure funds to pay for the purchased stock of the subsidiary corporations. If the promoters are able to retain sufficient stock to ensure control, the consolidation will remain under their management; if not, it will still remain a permanent consolidation, although its control will pass into other hands. When the persons who originally owned the stock of the subsidiary companies subsequently purchase an equivalent amount of stock of the holding company, the new organization will be owned largely and entirely controlled by the former proprietors of the competing plants.

In the second place, since a holding company may be formed to hold the stock of another holding corporation, it follows that by erecting one upon another, the amount of capital necessary to control an industry may be reduced to a nominal amount, provided the process be indefinitely extended.

Thus let us suppose that there are one hundred independent competing establishments within a certain industry and in each establishment there is invested one million dollars of capital.

[illegible] not of the concerns alone in the [illegible] monopoly the concrete relationship of the [illegible] discussing the operation [illegible] of any of

[illegible] corporation is quickly [illegible] to trusts a term [illegible] establishments of the same general character. [illegible] are situated so that apart from the lines of operation [illegible] overlap they are not of course competing in the [illegible] common product. In such cases, however, they are [illegible] [illegible] quantities of materials in the common market, and [illegible]

[illegible] however, since the establishments are of the same [illegible] character, the amalgamation may be centralized and [illegible] [illegible] introduced for the purpose of eliminating [illegible] [illegible] economy. Examples of this type of concentration [illegible] [illegible] [illegible] the public activities trust, such as gas, electric light [illegible] and the certain natural monopolies, overcome liberal in [illegible] different cities.

[illegible] the subsidiary corporations are direct competitors before [illegible] of the consolidation, the subsidiary corporation is the [illegible] of the original trust and has to a quite considerable [illegible] perpetuated its operations and increased in popular [illegible] and thought its name. The holding corporation has in [illegible] certain particular instances found it to be more efficient [illegible] the hands of this controlling class for the purpose of [illegible] of competitive establishments.

In the first place, a holding corporation consolidating an entire [illegible] group may in certain cases be formed without consolidation [illegible] owners of the subsidiaries and constituting a [illegible] [illegible] mutual agreement under the terms of union. This [illegible] accomplished by purchasing in the open market a controlling [illegible] in the stock of each of the concerns which it is desired [illegible] consolidate, the incorporation of the holding company, as [illegible] of the stock of the subsidiary companies for stock in the [illegible] company or being exchanged by the common owners of both trade [illegible] and the subsidiaries sale or even part of the holding [illegible] stock as may be necessary to secure funds to pay for the [illegible] stock of the subsidiary companies. If the promoters [illegible] to retain sufficient stock to secure control, the consolidation [illegible] under their management; if not, it will still [illegible] [illegible] consolidation, although the control will [illegible] [illegible]. In the instances who originally owned the stock [illegible] subsidiary companies subsequently purchased [illegible] stock of the holding company. The new organization will [illegible] [illegible] and entirely controlled by the former proprietors [illegible] holding plants.

In the second place, since a holding company may be formed [illegible] the stock of another holding corporation, it follows that [illegible] one or more another, the amount of capital necessary [illegible] an industry may be reduced to a nominal amount, involved [illegible] be indefinitely extended.

[illegible] there are one hundred independent [illegible] in a certain industry and in each [illegible] one million dollars of capital,

The total investment is thus one hundred millions of dollars, and a group of capitalists must necessarily possess somewhat over fifty millions to be certain of control over the industry by any of the ordinary methods of consolidation. A holding company with fifty-one millions of capital stock will control all the competing plants, and a group of capitalists with twenty-six millions of capital are able to permanently control the holding corporation. The formation of a second holding corporation with twenty-six millions of capital stock will control the first holding corporation, and a group of capitalists with thirteen and one-half millions are able to control the second holding corporation, and through it, the first holding company, and through that, all the plants in the entire industry. Each additional holding corporation superimposed upon the one preceding it reduces the amount of capital necessary for the control of the industry by a little less than one-half, and consequently the limits to the process are found only in the practical considerations connected with the duplication of the corporate organization.

It is, of course, evident that during the process of formation, that is, while the several holding corporations are being formed, it will be necessary for the organization to control somewhat over-one-half of the total investment in the entire list of corporations consolidated. This is, however, a banking or underwriting proposition that is likely to be adjusted to periods of easy money and after the final organization is completed, capital not necessary for the control may be returned to its normal channels.

In the third place, there is no natural limit to consolidation effected through the means of the holding corporation except that fixed by the boundaries of related industries. As long as there are advantages, either temporary or permanent, to be gained by the administrative union of independent industrial establishments, and so long as a combination of promoters and underwriters can command for a limited period sufficient capital to purchase a controlling interest in a group of corporations which it is desired to unite, the process of consolidation through the instrumentality of the holding corporation finds no natural check to its onward course. While it would thus be theoretically possible to effect a universal consolidation of all establishments in the corporate form by means of a single holding corporation, for practical reasons this method is never followed.

In the usual course of events, a holding corporation is chartered to consolidate all the establishments within a limited industrial group. A second holding corporation is formed, at the same time if capital is abundant, to perform the same work in a sister field. This process is continued until all the distinct groups in a great industry are united into a permanent consolidation through the several sister holding corporations. A holding corporation of a second order may then be formed and acquire a majority interest in the voting shares of each of the holding corporations previously formed, thus controlling the several holding corporations of the first order, and through them the subsidiary corporations operating all the establishments in the entire industry in question. The same process may then be carried out in all the great interests of any country, and finally, a holding corporation of the third order formed to acquire control of all the holding corporations of the second order, thus consolidating the material interests of any country which sanctions the promotion of such organizations. Moreover, the more holding corporations introduced into the plan

[illegible] one hundred millions of dollars, [illegible] must necessarily possess somewhat [illegible] be certain of control over the industry by [illegible] methods of consolidation. A holding company [illegible] millions of capital would control all the [illegible] of a second holding corporation with twenty-six [illegible] capital would control the three operating companies [illegible] capitalized with fifteen and one-half millions are [illegible] the second holding corporation, and through it, the [illegible] company, and through them, all the plants in the [illegible]. Most southern holding corporation accomplishes [illegible] proceeding it reduces the amount of capital necessary [illegible] control of the industry by a little less than one-half, and [illegible] only in the light to the proposes are found only in the practical [illegible] conditions connected with the duplication of the corporate [illegible] tion.

It is of course, evident that during the process of formation, [illegible] while the several holding corporations are being formed, [illegible] moose are for the organization to control somewhat over- [illegible] of the total investment in the entire list of corporations [illegible] consolidated. This is, however, a banking or underwriting [illegible] that is likely to be adjusted to various of any money [illegible] the final organization is completed, capital not necessary [illegible] control may be returned to its normal channels.

[illegible] through the loans of the holding corporations except that [illegible] a boundries of federal industries. As long as there [illegible], either temporary or permanent, to be gained by [illegible] the union of independent industrial establishments, [illegible] as a combination of promoters and underwriters can [illegible] a limited period sufficient capital to promote a con- [illegible] terest in a group of corporations which it is desirous [illegible] holding corporation finds no natural owner to its control [illegible] while it would thus be theoretically possible to effect [illegible] consolidation of all establishments in the corporate [illegible] is never followed.

[illegible] usual course of events, a holding corporation is out- [illegible] consolidate all the establishments within a limited [illegible] group. A second holding corporation is formed, or the [illegible] capital is abundant, to perform the same work in [illegible] This process is continued until all the district [illegible] [illegible] holding corporations. A holding corporation [illegible] order may then be formed and possess a majority [illegible]

cont'd/ling

[illegible] in the entire industry in question, [illegible] carried out in all the great interests [illegible] holding corporation of the third [illegible] of all the holding corporations of [illegible] the material interests of any [illegible]

between the ultimate holding corporation and the ultimate operating corporations, the less the actual capital required both during the formation of the grand consolidation and in the control of it after its formation.

It is thus evident that the holding corporation is the most efficient instrument that up to this time has been devised for the formation and control of monopolies which depend upon organization for their successful operation. Since, however, such organizations are absolutely dependent upon the State within which they are formed for the right even to exist, an easy method for their effective control or complete prohibition is not lacking. Just as the Elizabethan monopolies were granted by the Crown and were terminated when the Crown pleased to order their destruction, so all monopolies created and maintained through the instrumentality of the holding corporation are creations of the State and may be dissolved whenever the State so directs.

In the United States the legal status of the holding corporation is exceedingly complicated, not by virtue of the nature of such organizations, but on account of the conflict of two jurisdictions, that of the several States and of the Federal government. Since each of these jurisdictions is by the Constitution of the United States supreme within its own particular field, and since the Constitution gives the Federal government authority over interstate commerce only, the central government has the right to interfere with corporations chartered by the several States only so far as their interstate operations are concerned. That is, a holding corporation, organized under the laws of any of the several States for the purpose of consolidating several corporations, is subject to federal control only so far as it can be shown to interfere with and restrain interstate trade.

The attitude of the several States toward the holding corporation varies widely. Some permit the formation of such corporations without placing any restrictions upon the extent to which the consolidation may be carried; others prohibit the formation of monopolies under any form, but allow holding corporations to be organized and to operate so long as they do not through this instrumentality maintain monopolies; others do not provide for the organization of holding corporations at all; and in a few cases the formation of corporations for the purpose of holding stocks in other companies is definitely forbidden.

The first important case to come up, in this connection, under State corporation law is known as the Chicago Gas Trust case. For some years, four gas companies incorporated under the laws of Illinois had been operated in Chicago under a division of the territory combination. In 1892, in order to assure the permanent harmonious relations of these companies, the Chicago Gas Trust Company was incorporated under the laws of Illinois for the purpose of constructing and operating gas companies and authorized in addition to purchase, hold, and sell the stock of gas companies in Chicago and in any other part of Illinois. The new company acquired a controlling interest in the stock of the four existing gas companies in Chicago and proceeded to operate them practically as though the subsidiary corporations had been dissolved and the plants were owned by one company. The legality of the holding corporation was attacked in the courts on the grounds, first, that the statutes of Illinois made no provision for the organization of a holding corporation, and second, that even if the holding of stock were found

to be lawful, the organization must be still held illegal as constituting a monopoly in restraint of trade within the State. The general incorporation act of Illinois provides for the organization of corporations for manufacturing and commercial purposes by using the general phrase for "any lawful purpose." It was therefore contended that since the purchase and sale of stock was permitted by the laws of the State, any corporation organized for such a purpose must of necessity be organized for a lawful purpose and was therefore sanctioned by the State law. The court held, however, that since a statute of this kind was a grant to the incorporators, its terms ought to be strictly constructed; that if the Legislature had wished to authorize holding corporations they should have distinctly sanctioned such organizations by granting the right to purchase, hold, and sell stock in other corporations. Hence the Court declared the Gas Trust illegal without considering its monopolistic features at all. The Chicago Gas Trust Company was dissolved and a new company formed which acquired directly the properties previously controlled through the holding corporation. In those States which followed the policy adopted by Illinois, the holding corporation therefore has been unable to gain a footing, but under the laws of New Jersey, Delaware, Maine, and other States, an opportunity has been afforded for the formation of holding corporations wherever they have been deemed advantageous; consequently the opposition of the States refusing to sanction the holding corporation has been of small importance.

Under the authority granted by the commerce clause of the Constitution the Federal government enacted in 1890 the Sherman Anti-Trust Act, declaring "every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States" illegal, and making it a criminal offence to monopolize or attempt to monopolize the interstate commerce of the United States. In view of the conditions existing at the time the Act was passed, as well as from the discussions in Congress, it is generally admitted that the purpose of the anti-trust legislation was to prevent the formation of monopolistic consolidations of manufactures located in the several States, and to compel the dissolution of such organizations already in existence.

In the first important case determining the status of the holding corporation under Federal law, the Supreme Court held that the purpose of the company was to consolidate the manufacturing of refined sugar. That while such a consolidation might act in restraint of interestate trade, nevertheless such restraint was an incidental result of the organization of the holding corporation and not its primary purpose. Hence the American Sugar Refineries Company, the successor of the Sugar Trust previously held illegal under the laws of New York, was held to be free from the penalties imposed by the Sherman Act of 1890. The holding corporations organized in the purely manufacturing industries, even though they virtually monopolized the production of some particular commodity, were held therefore to be free from public control on the following grounds: first, they were permitted by the States from which they held their charters, and second, the United States government had no authority over manufacturing. In order, therefore, that the monopolies in the holding corporation form be held illegal, one of the following changes in our laws must be made: either the States must without exception refuse to permit the formation of consolidations through the agency of the holding corporation, or the Supreme Court of the United States must practically reverse its decision in the sugar refiners case, thus holding that the primary purpose of any

corporation which virtually controls an entire industry is to control the sale of the products rather than to consolidate the manufacturing processes, or third, the United States Constitution must be amended, extending the scope of the commerce clause to include industrial corporations engaged in manufacturing in more than one State.

Two years later action was brought under the same Act against the Trans-Missouri Freight Association, an organization of the railways south and west of the Missouri river, for the purpose of fixing rates and fares on interstate traffic. In this case the court decided that the Sherman Act applied to railroads in their interstate business. The general principles of this decision were reaffirmed in the Joint Traffic case a year later and as a result of these decisions the chief economic effect of the Act of 1890 has been, not to prevent the consolidation of manufacturers, but to prevent open agreements among the railroads of the United States and thus to encourage secret arrangements and indirect methods of securing harmonious traffic relations. Wherever possible some formal method of securing this end was adopted. Sometimes it was the voting trust, sometimes a system of leases, sometimes a holding corporation, and when for any reason neither of these methods was found feasible, the community of interest plan was adopted. Of these four methods the holding corporation obviously possessed marked advantages. It had been used by both the Baltimore & Ohio and the Pennsylvania for a half century to control their network of railroads west of the Appalachians, and in like manner, but somewhat later, by the New York Central to control the West Shore, the Michigan Central, the Lake Shore, and its other western lines. In the same way the Boston & Maine consolidated a large portion of the railways in northern New England, and the New York, New Haven & Hartford those in southern New England. At the same time the Southern Pacific in the West, the Rock Island in the central States, the Erie in the eastern States, and the Southern Railroad in the Southeast were busily engaged in extending their systems through the holding corporation, and in addition, most of the other railways in various parts of the country had made use of the same device with equally successful results and without the interference of the Federal authorities.

In the Northwest two parallel railways, the Great Northern and the Northern Pacific, had been operating independently of each other in comparative peace for twenty years. Each road was vitally interested in the development of the trade with the Orient. Each was dependent on pacific traffic arrangements with each other and with connecting lines to Chicago territory. It was first proposed to incorporate a holding company to take over the control of the Hill interests in the Great Northern and thus perpetuate the harmonious relations then existing. This method was rejected as too exclusive and then "the question came up, Why not put in the Northern Pacific?" Meantime the two roads had been making plans for a Chicago connection, preferably by securing control of an existing line. Several railroads were considered, but finally the Burlington was determined upon as the most available. Arrangements were perfected by which the Northern Pacific acquired one-half of the Burlington capital stock and the Great Northern the other half, the two roads issuing their joint bonds in payment thereof. While these arrangements were being negotiated, the Union Pacific interests, under the direction of Messrs. Harriman and Schiff, began buying Northern Pacific stock, in order to protect the traffic relations of the Union Pacific with the Burlington railway. The Morgan and Hill party succeeded, however, in gaining control of

the Northern Pacific by taking advantage of a provision in its charter which permitted the retirement of the preferred stock. For the purpose of preventing such struggles for supremacy in the future, and to insure the harmonious development of the great railways of the Northwest, the original idea of a small holding company was extended, and the Northern Securities Company was incorporated under the laws of New Jersey on the twelfth day of November, 1901.

By the terms of its charter, the Northern Securities Company was empowered to purchase, hold, and sell securities in other corporations, to aid in any manner such corporations, and to acquire and own such real estate as might be necessary for the transaction of its business. Shortly after its incorporation, the Northern Securities Company acquired by exchange of stock with the shareholders of the two companies, about 76 per cent. of the capital stock of the Great Northern Railway Company and approximately 96 per cent. of the stock of the Northern Pacific Railway Company. Late in December, 1901, the Interstate Commerce Commission began an investigation into the subject of railroad consolidation with the object of throwing light upon the Northern Securities venture. Early the next year suits were brought independently by the State of Minnesota and the United States for the purpose of testing the legality of the Northern Securities Company and securing its dissolution in case it should be found to be illegal. In the Federal case suit was brought under the Sherman Anti-Trust Act and section five of the Interstate Commerce.law. The important questions raised and discussed in this case were as follows: first, was the Northern Securities Company, having purchased a controlling interest in the stock of two parallel and competing railroads, a combination in restraint of trade; second, evenif a monopoly had thus been created, had the Federal government the right to interfere with the property rights of persons who had invested in a corporation created by one of the States?

In its answer to the first question, the court followed closely the reasoning and the decision in the Trans-Missouri Traffic case. Consequently it was held that any combination having the power to restrain interstate trade, even though it never exercised it, was illegal under the Sherman Act and that the Northern Securities Company, if not a trust, was a "combination in restraint of interstate and international trade." The second question was the cause of an exhaustive discussion, since it involved a consideration of the powers of the national government to regulate the "affairs or conduct of State corporations engaged as carriers of commerce among the States or of State corporations which although not directly engaging themselves in such commerce yet have control of the business of interstate carriers." Granted that the Federal government had been intrusted by the Constitution with exclusive control over interstate commerce and that through the instrumentality of the holding corporation a consolidation having the power to exercise monopolistic control over such commerce had been created by one of the States, had the Federal government the power to compel the dissolution of the creation through which the monopoly was established, or must it content itself, as suggested by the attorneys for the corporation, with the punishment of the subordinate companies for open and overt monopolistic practices? The real question as it appeared to a majority of the court centered in the query, Was the holding corporation known as the Northern Securities Company an investment company in the ordinary sense of the word, or a "custodian" of the stocks of the railways which it had united into one organiza-

tion? If the holding company were an investment corporation, then to order its dissolution would be an interference with property rights which the Supreme Court would be the last to disregard. If it were a custodian of stocks, an instrumentality created for the purpose of controlling and possibly restraining interstate commerce, then to order its dissolution and the return of the stocks to their equitable owners would not constitute an interference with the property rights of the stockholders in the constituent companies, since Congress had by the Sherman Act declared that property rights might not be created through the monopolization of interstate commerce. In the words of the court, "the decree, if executed, will destroy not the property rights of the original stockholders of the constituent companies, but the power of the holding corporation as the instrument of an illegal combination of which it was the master spirit to do that which, if done, would restrain interstate and international commerce." The court adopted the latter view and consequently affirmed the degree of the Circuit Court, which enjoined the holding company from voting the stock or from exercising any control over the railway companies whose stock was held; and further, it enjoined the constituent railroad companies from paying any dividends to the holding company on the stock which the holding corporation held in its treasury.

As a result of this decision, the Northern Securities Company, by resolution by the board of directors approved by the stockholders at a special meeting held on April 21, 1904, provided for the reduction of its capital stock, by 99 per cent., through the exchange of $39.27 of stock of the Northern Pacific Railway Company and $30.17 of the stock of the Great Northern Railway Company for each share of the stock of the Northern Securities Company. An injunction was sought by the Harriman interests to prevent the consummation of this plan, on the ground that each stockholder was entitled to receive the original shares deposited rather than his ratable proportion of the assets of the company. In support it was argued that the Northern Securities Company having been held an illegal corporation was void from the beginning, and therefore the title to the securities deposited had in fact never passed from the original owners to the Northern Securities Company. The court denied the injunction on the ground that the parties had sold their stock to the Northern Securities Company with full knowledge of the proceedings and condition and that the sale was on their part absolute and unconditional: therefore, the title to the stocks had intentionally been passed and consequently the former owners could not claim the specific shares. The decision of the Supreme Court in the Harriman injunction suit is likely to have important results in the future. While the holding company as a means of establishing and maintaining control of an industry was declared illegal in the Northern Securities case, the community of interest principle, which secures the same results, temporarily at least, is stamped with the judicial approval. It would seem, therefore, that under any circumstances the holding companies, whenever declared illegal, would have a permanent refuge in the community of interest method of control.

In some respects, the most significant of all the cases to come before the courts is that of the Standard Oil Company, recently decided in the Circuit Court. After the trust was declared illegal in 1892, the trustees proceeded to dissolve the organization by an exchange of the certificates for a pro rata assignment of shares in twenty selected corporations which controlled the remaining companies in the original trust. In 1899 the charter of the Standard

Oil Company of New Jersey was amended to permit it to purchase, hold, and sell the stock of other corporations in this and other countries, and at the same time its capital stock was increased to $100,000,000.

This company then exchanged its stock for shares in the nineteen selected corporations and became the holding company for the Standard Oil interests. Late in 1906 suit was brought in the United States Court by direction of the attorney-general of the United States and on the nineteenth of November, 1909, almost exactly three years later, a decision was rendered, declaring the Standard Oil Company of New Jersey, the holding corporation, an illegal combination under the Sherman Anti-Trust Act and enjoining it from further continuing business in its present form. It was, of course, generally admitted that the Standard Oil Company had effected a substantial monopoly of the petroleum industry in the United States. A similar condition, however, existed in the sugar refining industry at the time the Sugar Refineries case was decided and there the cause was dismissed on the ground that the control over manufacturing was intrusted by the Constitution to the several States. The Standard Oil Company, however, was both a manufacturing company and a commercial company. Its business as a transporter of oil surpassed in extent and influence that of many of the railroads as carriers of commercial products. Moreover, the company had for years been extending its business into the commercial fields in the wholesale and retail distribution of its manufactured products; consequently, when the plea was entered in its defense that it was a private corporation, not a public utility corporation, and therefore to be classed with the sugar refining company rather than the Northern Securities Company, the court held that it was engaged in commerce and that among corporations engaged in this domain the Sherman Act made no distinctions. The decision of the court in this matter seems, therefore, to be directly in line with all the previous decisions of the Supreme Court in regard to the scope and meaning of the Anti-Trust Act. The principal conclusions, as stated by Judge Hook in a concurring opinion, express briefly but comprehensively the general conclusions reached.

"The principal conclusions, upon which we are all agreed, may be briefly stated as follows: A holding company owning the stocks of other concerns whose commercial activities, if free and independent of a common control, would bring them into competition with each other, is a form of trust or combination prohibited by Section I of the Sherman Anti-Trust Act.

"The Standard Oil Company of New Jersey is such a holding company. The defendants who are in the combination are enjoined from continuing it and from forming another like it. The holding company is enjoined from exercising the rights of a stockholder in the subordinate companies, and they are enjoined from allowing it to do so or to benefit therefrom in the way of dividends.

"It is thought that with the end of the combination the monopoly will naturally disappear, but lest, instead of resulting that way, the monopoly so wrongfully gained be perpetuated by the aggregation of the physical properties and instrumentalities by which it is maintained in the hands of a member of the combination and the liquidation and retirement from business of the other members, it is held that such a course would violate the decree."

It would seem from the conclusions reached in this case that a considerable change in the attitude of the court toward the holding

company and occurred since its first decision in 1894. It is entirely possible, therefore, that in the future the Supreme Court will hold that monopolistic aggregations of capital in the purely manufacturing field must of necessity directly affect interstate commerce in the commodity manufactured, and that under such circumstances many of our larger industrial consolidations, especially those in the holding company form, may be declared illegal and forced to dissolve, even though their monopolistic power may never have been used to the disadvantage of the public.

While the process of determining the legal status of the holding company has been in progress, neither the States nor the corporations have been idle. Following the lead of New Jersey, thirteen of the other States of the Union have enacted statutes definitely approving the policy of a corporation holding stock in other corporations, and in several of the other States this policy, while not directly sanctioned by statutes, seems to have the silent approval of the administrative officers and the courts. At the same time the corporate interests have eagerly been taking advantage of the opportunities thus offered to consolidate the various industries on the ground, evidently, that a consolidation once effected is not likely to be disturbed. This movement has been most marked in the railway domain, where it originated. As shown by the investigation made by the Interstate Commerce Commission in 1906, somewhat less than one-half (46 per cent.) of the total capital stock issued by the railways of the United States was held by railway corporations, and the practice seems to be increasing rather than the reverse. While no thorough investigation of the situation in the public service field has been made, an examination of the available data shows the same movement, somewhat less advanced, but progressing with great rapidity, especially since 1905, in almost all lines of that important domain. In a large proportion of the cases the consolidation of all the public service companies within a given territorical area is formed, partly for the sake of economy and partly for the sake of monopolistic control. In the strictly manufacturing field the consolidation movement, effected largely through the instrumentality of the holding corporation, may be compared to a volcanic eruption, reaching a climax in the years 1899-1901, and then followed by a period of comparative quiet. In each of the more important industries, a holding company exercises a very large influence, and in some cases practically dominates the industry. In the commercial field the consolidation of mercantile houses has apparently just begun, the Associated Merchants Company of New York being the most important instance at the present time. The success of this company would indicate that, if such organizations are not prevented by legal restraint, they are likely to become of large importance in the near future.

With the States furnishing the opportunity and in some cases actively approving the consolidation of industrial establishments through the holding company, with the industrial and financial leaders seeking its many advantages, the dangers threatening our industrial system are likely to be overlooked or forgotten. On the one hand strands monopoly with its palsying touch; on the other, the disruption of immense business organizations by order of the judges, bound by law and by every sacred obligation to destroy that which the States and the corporate interests are busy establishing. In order to avoid both of these threatened disasters to our future industrial development, it is evident that a radical change in our

corporation law ought to be effected by the States and the Federal government acting in harmony. While it is beyond the scope of this article to discuss such changes in detail, the main outlines may be briefly indicated.

In the first place, the United States should by law provide for the incorporation of all business enterprises engaged in interstate trade or in manufacturing in more than one State. Such corporations should be permitted to hold stock in other corporations under proper government supervision and control.

In the second place, a national commission should be created to supervise the incorporation of such industrial enterprises and the control of their corporate operations after the period of formation. The Bureau of Corporations might be entrusted with this particular task for corporations within its particular field and the Interstate Commerce Commission those engaged in the transportation of goods and messages; or an entirely new commission might be created to supervise the operation of all enterprises incorporated under the Federal law.

In the third place, the several States should provide for the incorporation of business establishments doing strictly a State business and for those only. Such corporations should not be allowed to hold stock in other corporations.

That important changes in the formal relations of the great corporations and the public administration must come in the future is not open to question. If they do not come through changes in our Constitution and statute laws, they are certain to come more slowly, but none the less surely, through a series of judicial decisions. In the interests of public welfare, as well as of private interests, they ought to come through legislative action, and that in the immediate future.

Maurice H. Robinson.

1. How long will it last.

2. Do it good or bad.

Reading #20.

THE FORMATION AND CONTROL OF TRUSTS

By Arthur T. Hadley, President of Yale University
Scribners, November 1899, p. 604 ff.

In the year 1898, the new companies formed in the United States for purposes of industrial consolidation had a capital of over nine hundred million dollars. When this fact first transpired, it was regarded as surprising. Now it has become commonplace. For in the earlier half of 1899, according to the careful estimate of the Financial Chronicle, the capital of the new companies of this character was three thousand one hundred million dollars, or more than three times that of the whole year preceding.

It is hard to appreciate at once the magnitude of these figures. No single event of a similar character, either in the American or in the English market, has involved such large and sudden transmutations of capital. Compare the history of railroad investments. Even in the year 1887, so conspicuous in our railroad history, the new capital used in building thirteen thousand miles of line can hardly have reached seven hundred million dollars. In the whole period of rapid expansion from 1879 to 1882 the volume of new railroad securities issued did not equal the industrial issues of this single half year alone. Under such circumstances, the question of industrial consolidation becomes one of pressing importance. Is this a transient movement, or is it a manifestation of permanent tendencies? How far is it likely to go? To what limits, commercial or legal, is it subject? How are its evils to be avoided. Is it, as the socialists claim, a stepping-stone toward a new organization of industry under government authority? These are the questions which must be asked and answered.

It is safe to say at the outset that this movement is not likely to continue long at the rate which it is now maintaining. While some of the industrial issues represent an investment of new capital, a much larger number represent a conversion of old capital. To such conversion there is, of course, a natural limit, when all, or nearly all, the older enterprises in an industry have become consolidated. Of the three thousand million dollars of securities placed on the market in the first half of the current year, it is doubtful whether our thousand million, or even five hundred million, really represent new capital put into the various lines of business enterprise. Measured in dollars and cents, the industrial growth is a comparatively small element in this movement, and the financial change of form a much larger one. We may, I think, go a step farther, and say that in no small part of these enterprises the financial motive of rendering the securities marketable is at present more prominent than the industrial motive of rendering the operations of the consolidated company efficient.

Let us see what is the difference between these two kinds of motives, and how they operate at the present juncture.

A man who invests his money in a business has two distinct objects. He wishes to secure as large an income as possible; this is his industrial motive. He also wishes to be able to get his money back whenever he needs it, and if possible to get back more than he put in; this is his financial motive. The business must be profitable; the security must be marketable. To a certain extent these two things go hand in hand. An investment which had paid large and

fairly regular dividends for a serioes of years becomes known in the local security market, and can be transferred to other hands at comparatively slight sacrifice in case the owner desires to sell it. But this is only true up to a certain point. Some of the things which make an industry profitable to the individual owner tend to make its securities less marketable instead of more so. A local business which a man has under his own eye, and whose details he knows by experience, may be a very sure investment for him, and a relatively unsafe one for others; good to hold, but bad to sell. The intimate personal knowledge which is his protection becomes a possible menace to other holders. The majority of investors throughout the country cannot safely have anything to do with it. In such an industry the market value of the stock when it is sold is apt to be less than the proportionate to its income-producing power.

A great many of the manufacturing industries of the country have remained in this localized condition. If we compare the past history of industrial investments and of railroad investments, we are struck with the relative narrowness of the market for the former. The securities of a good railroad could find purchasers anywhere. If the price paid for the stock was low in proportion to the return, it was only because people distrusted its future earning capacity. Even a small railroad might have a national reputation as an investment. The demand for the securities of Iowa railroads was not in any sense confined to one State or one section. As much as ninety-seven per cent came from districts remote from Iowa. But the demand for the securities of an Iowa factory was for the most part local. Its operations were not performed under the public eye. Its stocks could therefore safely be held only by those who had private advantages for getting an inside view.

But when an industry throughout the country was consolidated, this condition rapidly changed. A very much larger public was ready to buy securities of the American Sugar Refineries Company or the American Tobacco Company than would have cared to invest in any of the individual concerns of which they were composed. The national extent of the organization gave the holder of its securities larger and steadier opportunities of converting his investment into cash than he could have had when his factory remained separate from the others; and it often, though not always, enabled him to realize a much higher price than he otherwise would have obtained. While this was not always a dominant purpose in the formation of these earlier "trusts", it was an incidental advantage by which their organizers were quick to profit. Besides the motive of economy in operation, which was first urged as the reason for entering these combinations, the motive of selling securities easily and at a high price soon took its place as one of co-ordinate importance.

Apart from this legitimate increase in the value of trust securities, due to the national extent of industry which enables them to find a market among a larger circle of investors, there is an illegitimate increase due to the opportunities which they afford for manipulation by inside rings. There is a fashion in investments as in everything else. A large section of the public buys the kind of thing that others are buying. Sometimes it has been land; sometimes it has been railroads; just now it is industrials. In a year of prosperity, with a slight tendency toward inflation, prices of all

kinds of securities tend to rise. The man who has bought to be in fashion is pleased with the increase in the nominal value of his investment and buys more. Those who are connected with the management see an opportunity of disposing of some or all of their holdings to great advantage. Before the inevitable crash comes they have converted most of their capital into money; and the outside buyer is a loser. Prior to the crisis of 1873 the favorite chance for these operations was found in railroad enterprise; but railroad traffic and railroad accounts are now so much supervised that the possibility of such transactions in this field is less than it was thirty years ago. And, what is of still more importance, a series of hard experiences has made the investing public quite shy of dishonest railroads. In manipulating the stock of "industrials", the speculator finds these obstacles less serious. The authorities have not learned to exercise adequate supervision; the public has not accustomed itself to use caution.

The buying of industrial securities simply because it is the fashion to do so is bound to come to an end. The speculation now so actively indulged in must reach its own limit in process of time. When the investors as a body discover that the system of first and second preferences is a fatally easy means of putting an individual security-holder at the mercy of a dishonest board of directors, we shall probably witness an apparent stoppage in the rapid process of industrial consolidation. In fact, there may be a reaction, and a reconversion of the united companies into separate ones, if, as has happened in other cases, the unreasoning fondness of the public for a particular form of investment is followed by an equally unreasoning aversion of all enterprises of this form, legitimate as well as illegitimate. Such a reaction has taken place more than once in the economic history of the nineteenth century. Over-speculation in English railroads in 1844, in American railroads in 1873, in produce warrants in 1881, in car trusts in 1886, not to mention a score of other less important instances, produced in the years immediately following an almost absolute stoppage of the issue of what had seemed previously a very promising and important form of investment or speculation.

We are safe in concluding that the rate of formation of large industrial companies will be less rapid in the future than it has been in the past. Consolidations which have been formed for selling securities and deceiving investors will cease. But there will always remain a considerable number which are formed for industrial rather than financial purposes; and these will probably be more important twenty years hence than they are to-day. As the world moves on, the relative economy of large concerns makes itself more clearly known. The steady movement in this direction is not confined to the United States. It is just as strongly felt in England; it is, if possible, even more strongly felt in Germany. If less is said about these industrial consolidations in Europe than in America, it is because they have proceeded more quietly and along more legitimate lines, not because they are fewer or less important. They have not advertised themselves so extensively, because they were not trying to sell their securities. This has prevented the public from knowing so much about them. It has kept them in some measure out of the market. But so far from interfering with their prominence in the actual operation of manufacture it has rather contributed to increase it.

The nature of the economy which is realized by these combinations has been set forth by so many writers that we can pass over this phase of the subject very quickly. This advantage is two-fold. In the first place, the consolidation of all competing concerns avoids many unnecessary expenses of distribution. Under the old system these expenses are very great. The multiplication of selling agencies involves much waste. Competitive advertisement is often an unnecessary and unprofitable use of money. Delivery of goods from independent producers, whether by wagon or by railroad, often costs more than the better-organized shipments of a single large concern. All of these evils can be avoided by consolidation. In the second place, a consolidated company has advantages in its power of adapting the amount of production to the needs of consumption. Where several concerns with large plants are competing and no one knows exactly what the others are doing, we are apt to have an alternation between years of over-production and years of scarcity - an alternation no less unfortunate for the public than for the parties immediately concerned. A wisely managed combination can do much to avoid this. By making its production more even it can give a constant supply of goods to the consumers and a constant opportunity of work to the laborers; and the resulting steadiness of prices is so great an advantage to all concerned that the public can well afford to pay a very considerable profit to those whose organizing power has rendered such useful service.

This is the picture of the workings of industrial consolidation which is drawn by its most zealous defenders. It is needless to say that it represents possible rather than actual achievement; that where one company has secured these results, five, or perhaps ten, have failed to secure them; that for one combination which has earned large profits by public service, many have tried to earn large profits by public disservice and have frequently ended in loss to themselves and to the public alike.

But as long as it is possible for a well-managed consolidation to do better work for all parties than could have been done under free competition, so long we may expect to see the movement in this direction continue. Where there is a real economy to be achieved, investors will try to take advantage of the opportunity. The attempt to prohibit them from so doing is likely to prove futile. There is no better evidence of the strength of the tendency toward consolidation than is furnished by the multitude of unenforced laws and decisions intended to prevent it. When railroads were first introduced, people's minds revolted against the monopoly of transportation thereby involved. Statutes were devised to make the track free for the use of different carriers, as the public highway is free to the owners of different wagons. But the economy of having all the trains controlled by a single owner was so great that people were forced to abandon their preconceived notion of public right to the track. They still, however, tried to insist that the owners of separate railroads should compete with one another, and passed various laws to forbid the formation of pools and traffic associations. Some of these attempts have been failures from the outset; others have simply hastened the process of consolidation of the competing interests which put them beyond the reach of the special law; the few which have been effective have done great harm and almost no good. The majority of thinking men have come to the conclusion that railroads in some sense a natural monopoly, and have classed them with waterworks, gas-works,

and other "quasi-public" lines of business, as an exception to the general rule of free competition. But we are now beginning to find that the same possibilities of economy which first showed themselves in these distributive enterprises may be realized also in productive industry. They are felt to a considerable degree in all kinds of enterprise involving large plant; and there is every reason to believe that the tendency toward consolidation will be as inevitable in manufacturing as in transportation. In the one case as in the other, we may expect that laws against pools will contribute to the formation of trusts, that laws against trusts will lead to actual consolidation.

On the other hand, we need not expect this process to be a sudden one. There are practical limits to the economy of consolidation, which are more effective than the legal ones. The difficulty of finding men to manage the largest of these enterprises constitutes the greatest bar to their success. Just as in an army there are many who can fill the position of capitan, few who can fill that of colonel, and almost none who are competent to be generals in command - so in industrial enterprise there are many men who can manage a thousand dollars, few who can manage a million, and next to none who can manage fifty million. The mere work of centralized administration puts a tax upon the brains of men who are accustomed to a smaller range of duties, which very few find themselves able to bear.

Nor is this all. The existence of a monopoly gives its managers a wider range of questions to decide than came before any of them under the old system of free competition. Where several concerns are producing the same line of goods the price which any of them can charge is largely fixed by its competitors. It is compelled to sell at market prices. The manager concentrates his attention on economy of production, so as to be able to make a profit at those prices while his rival is perhaps making a loss. But when all of these concerns are consolidated under a single hand, the power of controlling the prices of the product is vastly greater. The manager no longer asks at what rate others are selling; he asks what the market will bear. To answer this question intelligently he must consider the future development of the industry as well as the present. The discretionary power which the absence of competition places in his hands constitutes a temptation to put prices up to a point injurious to the public and ruinous to the permanence of the consolidated company. Our past experience with industrial consolidations proves that very few men are capable of resisting this temptation or of exercising the wider power over business which the modern system places in their hands.

The name trust, which is popularly applied to all these large aggregations of capital, was somewhat accidental in its origin. It has, however, an appropriateness which few persons realize. The managers of every consolidated enterprise whether based on a contract, a trust agreement, or an actual consolidation, are exercising powers to benefit or injure the public which are analogous to those of a trustee. It has been said that all property is, in its wider sense, a trust in behalf of the consumer. But where competition is active, the power of using your business methods to impose high prices is so far limited that the chance for abuse of this trust is greatly lessened. It is only in the case of large combinations, with their discretionary power for good or evil, that the character of the trust

reposed by society in the directors of its business enterprise makes itself really and truly felt. With these trusts, as with every other trust that deserves the name, it is hard to provide legislative machinery which will absolutely secure its fulfillment. The ability to handle any trust is the result of a long process of legal and moral education. We cannot make a law which shall allow the right exercise of a discretionary power and prohibit its wrong exercise. But it is possible to modify the existing law in a great many directions, which will hasten instead of retard the educational process. Thus far most of our statutory regulations have been in the wrong direction. We have attempted to prohibit the inevitable, and have simply favored the use of underhanded and short-sighted methods of doing things which must be done openly if they are to be done well.

To make matters move in the right direction, at least three points must be kept in view.

I. Increased responsibility on the part of boards of directors. Where the members of a board are working for their own individual purposes, ignoring or even antagonizing the permanent interests of the investors, all the evils of industrial combination are likely to be seen at their worst, and the possibility of improvement is reduced to a minimum.

In the first place, the mere fact that the directors are allowed to ignore their narrower and clearer duties to the investors prevents them from recognizing the very existence of their wider duties to the public. They think of business as a game, which they play under certain well-defined rules. They sacrifice those whom they represent in order to win the game for themselves. This wrong underlying idea prevents them from rightly conceiving of any trust which they may handle.

In the next place, the temporary interests which the directors pursue in endeavoring to manipulate the market are not likely to coincide with the interests of the outside public, whether laborers or consumers. The interests of the speculator may be furthered by these very fluctuations in price which it is the ostensible object of the consolidation to avoid. If a business like that of the Standard Oil Company is run with a view to the permanent interests of the public, it will generally be found that prices are made relatively low and steady, and that laborers are given constant employment; but in some other cases, where the property has been subject to manipulation, the results have been just the reverse.

Finally- and this is perhaps the most important point of all - if the directors are allowed to make their money independently of the interests of the investor and consumer both, the education in political economy which should result from business success or failure is done away with. If a man is managing a business with a full sense of responsibility to those who put money into the enterprise, a failure to serve the public means, in the long run, a failure of his own purposes and ambitions. If this failure is but partial, he will learn to do better next time; if it is complete, he will give place to someone else. But if he has taken up the industry as a temporary speculation, buying the securities at prices depressed by false reports, holding for an increase of value, and

selling them on false pretences to deluded investors, no lesson is learned by the management of the enterprise; and the same mistakes may be repeated indefinitely under successive boards of directors. Greater strictness with regard to the formation of new companies, increased publicity of accounts, clear recognition, legal and moral of the responsibility of directors who have made false reports to the stockholders - these are conditions precedent to any radical and thorough reform of existing abuses.

2. A change in the legal character of the labor contract.

Here we stand on more doubtful ground. It is easy to say that the present relations between large corporations and their employees are unsatisfactory. It is difficult to say just what should be done to make them better. As matters stand at present, a strike begun on trivial grounds may be allowed to interrupt the whole business of a community. The natural alternative would seem to be compulsory arbitration; but this in practice has not worked nearly as well as would be desired. It is probable that in this respect changes in the laws must come slowly. An obligation of a consolidated company to perform continuous service must be coupled with a clearer definition of the obligations of the workman in this respect. Whatever can or cannot be done by legal enactment, society must at any rate recognize that those whom it has placed in charge of large industrial enterprises are not simply handling their own money or other people's money, but are above all things leaders of men; and it must judge the financier, who has through his negligence allowed the business of the community to be interrupted by strikes, as it would judge the general who, in his anxiety to secure the emoluments of his office, had allowed his country to be invaded and his armies paralyzed.

3. An increased care in the imposition of high import duties.

In the past we have allowed the manufacturers in each line of industry a great deal of freedom to suggest what the tariff on the products of their foreign competitors should be, knowing that if it was placed too high the internal competition of new enterprises would reduce profits and prices to a not exorbitant level. Of course mistakes have been made in this matter which have caused serious and unnecessary variations in price; but as a rule domestic competition has set moderate limits to the arbitrary results of tariff-making. When, however, domestic competition is done away with, the danger is more serious and permanent. It is hardly possible to deal very directly with the tariff question without going beyond the limits of an article like this; but it is safe to say that in those industries which are at all thoroughly monopolized public safety will generally demand that duties be placed on a revenue rather than a protective basis. The fact that an industry can thus organize itself shows that it has outgrown the period of infancy. If it continues to demand a prohibitory tariff on its products, the presumption is that it is trying to make an arbitrary profit at the expense of the consumer.

Such are the general directions in which private corporations must expect increased restriction, as they become more or less complete monopolies. But there is a still deeper question which many are asking, and to which not a few are giving a radical answer. Will such monopolies be long allowed to remain in the hands of private corporations at all? Is it not rather true that this consolidation is a step in the direction of state ownership of industrial enterprise?

Is not a grave crisis at hand in which there will be a decisive struggle between the forces of individualism and socialism, of property and of numbers?

It is quite within the limits of possibility that many of these enterprises will pass into government ownership in the immediate future; but it is highly improbable that this tendency toward consolidation is increasing the dangers of a conflict between individualists and socialists. Its net effect is to diminish these dangers by making the question of state ownership relatively unimportant to the public as a whole. This may seem like a surprising statement, but there are a great many facts to justify it. There has been of late years, in connection with these movements toward consolidation, an approximation in character between private and public business. Formerly the two were sharply distinguished; today their methods are much closer to one another. Private business can do little more than pay interest on the capital involved, because of the increased intensity of modern competition. Public business can do no less than pay interest on the capital involved, because of the increased vigilance of the taxpayers; for the taxpayers will not tolerate a deficit which increases their burdens. But obviously the position of the consumer toward a private business which pays less than four per cent is not likely to be very different from his position toward a public business which must pay more than three. The distinction from the financial standpoint is thus reduced to a minimum; nor is it much greater, if we look at the matter from the operating standpoint. The officers of a large private corporation have almost ceased to come into direct contact with the stockholders; and to a nearly equal degree our public administrative officials who actually do the work have ceased to come into contact with the voters. The private officer no longer seeks simply to please the individual group of politicians. The man who does so is in either case charged, and rightly charged, with misunderstanding the duties of his office. The more completely the principles of civil service reform are carried out, the closer does the similarity become. The responsibility of public and private officials alike leads them to the exercise of technical skill and sound general principles of business policy, rather than to the help of influential private interests. Under these circumstances, the character of good public business and good private business becomes so nearly alike that it makes comparatively little difference to most of us whether an enterprise is conducted by our voters or by our financiers. The one question to ask is, which method produces in any case the fewer specific abuses. We may look with confidence to the time when the question of state ownership of industrial enterprises will cease to be a broad popular issue, and become a business question; which economic considerations may perhaps lead society to decide in favor of public control at one point and private control at some closely related point. There will, of course, always be a conflict between those who have more money than votes, who will desire to extend the sphere of commercial activity, and those who have more votes than money, who will desire to extend the sphere of political activity; but to the great majority of people, who have one vote and just money enough to support their families, it is not probable that this conflict will ever create a general issue of the first importance.

We may sum up our general conclusions as follows: So far as the

present tendency toward industrial consolidation is a financial movement for the sake of selling securities, it is likely to be short lived. So far as it is an industrial movement to secure economy of operation and commercial policy, it is likely to be permanent. Attempts to stop this tendency by law will probably be as futile in the field of manufacture as they have been in that of transportation. The growth of these enterprises creates a trust in a sense which is not generally appreciated; it gives their managers a discretionary power to injure the public as well as to help it. The wise exercise of this trust cannot be directly provided for by legal enactment; it must be the result of an educational process which can be furthered by widened conceptions of directors' responsibility. As this process of consolidation and of education goes on, private and public business tend to approach one another in character. The question of state ownership of industrial enterprises, instead of becoming an acute national issue, as so many now expect, will tend rather to become relatively unimportant, and may not improbably be removed altogether from the field of party politics.

II Merger & Amalgamation

Merger exists where we have several companies

A + B = A ~~amalgamation~~

A + B = C merger.

Gottschalk is just opposite

Community

Merger of three type

1 ~~Trustee device~~

2 Holding Co

3 Lease Hold. – RR mostly.

Amalgamation.

1. Single corporation.

I		II	III
~~Amal.~~ Mergers. Trustee device	HC	Leasehold.	II Analog. Single Corp	III C of I. Community of Interest

Bond Oil	1882		
Buckeye 1892	1892.		1892 - 99
Standard Oil of New Jersey organized!		1899	
		1911	
Sugar Trust	1883		
Buckeye	1890		
Single co.			1890

The Financiering of Trusts
By Hon. Charles S. Fairchild

The subject that I have been asked to present--"The Financiering of Trusts"--is one as to which there is, probably, much confusion in the minds of many people. But it is so simple and the process is so obviously the one that must be followed that I am doubtful if I can worthily take any of your time.

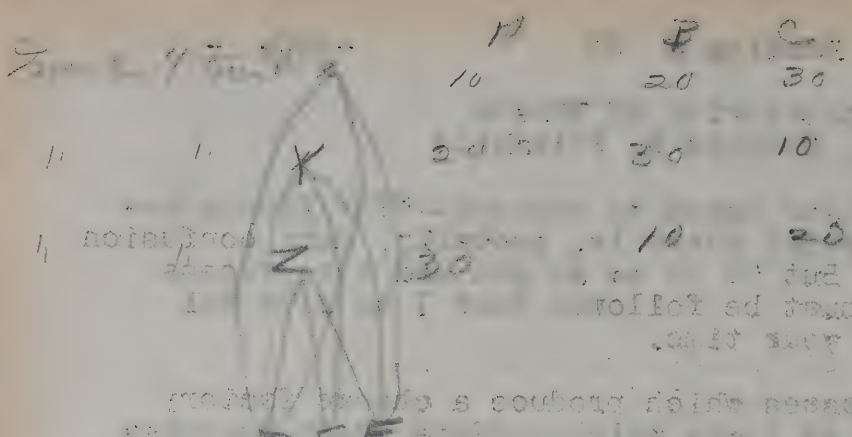
The motives and the processes which produce a cheese factory or creamery are much the same as those which produce other business combinations or so-called trusts. A,B,C,D, and E own dairy farms; they become satisfied in some way that they can manufacture and sell butter and cheese at greater advantage if they combine both for manufacture and sale than they can if they continue in the old way on each individual farm.

They may reach this conclusion through the talk of some man who wishes the job of managing the manufactory or by talk among themselves. In the one case there is a promoter; in the other, not.

But coming to my immediate subject, owing to the fact that usually the things which we have in mind now are made by the union, under a new corporation, of private concerns and of corporations more or less widely separated geographically, and because there are laws about corporations that must be complied with or evaded, some things are done in their financiering which make apparent differences between them and the familiar cases of which I have spoken. But the difference is more apparent than real, as will appear when both are well understood.

Several manufacturers whose factories are in as many different places come to believe that it is for their advantage to unite their various businesses: they consult as to the value of their respective real estate, tools, machinery and business connections; then they organize a corporation under some state where the laws are suitable for their purpose, providing for a maximum of securities of various kinds, mortgage bonds, preferred and common stock--all or any of these as they may determine--and then sell their properties to the new corporation, taking in payment the securities of the new corporation in such proportions as the value of each property is to the value of all of them.

Or in another case the promoter acts. He goes to each of the manufacturers, obtains an option upon their properties, agreeing to pay for the same; it may be in cash or in the securities of the new corporation, or partly in cash and partly in securities. He organizes his company and agrees to sell the properties upon which he has his options to the new corporation for all the securities that it has issued. He then distributes part of these securities to those who have agreed to take them in payment for their properties, and sells to outsiders--new men--generally called "the public," another part of the new securities for cash, which is used to pay the money to those manufacturers who have agreed to take money in whole or in part, and also an agreed part of the cash thus realized is kept in the treasury of the new corporation as a working capital to avoid the necessity of selling the paper of the new company, as probably all of the concerns thus combined had been obliged to do before the combination was made. Thus provision of cash for


10
20
30
X
30
10
10
20
Z
30
DEF

working capital is also generally made in whatever way the combination be brought about; it is certainly always done if good judgment and prudence have been respected in the formation of the combination. If many cases, I think it may be said, that one of the strong inducements which have caused manufacturers to enter into these combinations has been that they might be freed from the worry and peril of constantly raising money on their business paper to carry on a business which was not equipped with sufficient cash capital.

After enough of the securities have been distributed and sold to fulfill the engagements of the promoter, he tries to have a good supply left in his hands to reimburse him for his expenses and pay him for his time and labor. In some instances this pay is said to have been very large. Naturally as to this I have no positive knowledge in any instance, only rumor and gossip. This method of payment is the same as that of the reorganizers of railroad and other concerns; it is in the nature of a lawyer's contingent fee, dependent upon the success of the undertaking or suit, and is naturally larger than it would be if made in cash.

During the processes which I have described, underwriting syndicates have probably been employed to make sure that a sufficient amount of securities shall be sold to secure the cash needed, and there have been one or more bankers who may have loaned money needed, pending the final launching of the new company and may also have been employed to bring out its securities, i.e., offer them for subscription by the public. Syndicates and bankers must be paid their commissions out of the surplus securities.

Perhaps a concrete illustration may help toward a clearer understanding of just how this part of the financiering of these combinations is managed. Let us assume that the promoter has secured options upon the plants, assets and good-will of ten separate manufacturing concerns, for which he is to pay, under the terms of his options, $3,000,000 in cash and $6,000,000 in preferred stock and $4,000,000 in common stock of a new company of $20,000,000 capital (half preferred stock) to be formed to acquire the entire plants, stock and other assets, good-will, etc., of the ten concerns specified, and to have when formed at least $1,000,000 of working capital. As soon as these options are in this definite shape the promoter goes to some financial house or firm of private bankers for assistance in raising the $4,000,000 of cash which the plan requires. He presents the facts as to his options and his program and proposes that if they will arrange a syndicate to underwrite or guarantee the purchase of $4,000,000 of preferred stock and $4,000,000 common stock for $4,000,000 in cash he will give them a commission of 5,000 shares of the common stock of the company. The bankers give the entire project careful investigation, usually employing experts and accountants to report upon the facts as to the business and profits of the constituent companies. If the result is satisfactory, the promoter gets a favorable answer and the bankers become the managers of an underwriting syndicate. In carrying out this part of the program they proceed to lay the matter before the individuals or companies to whom they desire to offer an interest in the marketing of the stock. This is naturally done by submitting copies of a syndicate agreement reciting that the subscribers agree to purchase at par the number of shares of preferred stock set opposite their respective names, receiving as a bonus an equal amount of common stock--but the whole conditioned upon there being an aggregate subscription equal to the $4,000,000 to be raised. If this amount is oversubscribed some subscriptions are either thrown out or cut

down. If it is not subscribed the project has to be abandoned or modified. In some cases the desired end is sought by a public announcement of the terms on which subscriptions will be received.

If the entire $4,000,000 is subscribed the next step is to require the payment of the subscriptions allotted. This gives the syndicate managers the $4,000,000 cash which the plan requires. The new company is then incorporated with an authorized capital of $10,000,000 preferred and $10,000,000 common stock, of which perhaps $5,000 of the common stock is paid up at once; and on this the company begins business with a regular board of directors. The stockholders owning this first $5,000 of stock (50 shares) then vote to authorize the increase of the capital to the amount fixed in the certificate of incorporation and approve the issue of all the additional stock in a block to John Doe, the promoter, in exchange for the various plants, assets, etc., and the $1,000,000 cash which the new company was to acquire. Then by simultaneous transactions John Doe gets the $10,000,000 preferred stock and $9,995,000 common stock; of this $6,000,000 of the preferred and $4,000,000 of the common stock are passed on to the owners of the original companies; $4,000,000 of each is passed to the syndicate, whereupon it turns over to John Doe the $4,000,000 of cash, which he in turn uses to pay the cash required by the options and that which is to go into the treasury of the new company; at the same time the titles of the various properties are passed to the new company. John Doe then finds himself--after turning over to the banking house which formed the syndicate the 5,000 shares of common stock agreed upon as commission for their services--the possessor of 14,950 shares of common stock, of the par value of $1,495,000.

In planning the details of the various consolidations there has been great diversity. In some cases there has been only a single kind of stock--common stock. Such, for example, are the Standard Oil Company and the Amalgamated Copper Company--both among the largest of the so-called trusts. In most cases, however, there have been two kinds of stock--preferred and common--frequently evenly divided in amount between the two. When put out to the public through a syndicate, the preferred stock has usually been offered at par with a bonus of an equal amount, or 60 per cent, 75 per cent, or 80 per cent, in common stock. In the terms on which the preferred stock is issued, there is equal diversity. So far as one can generalize, it might perhaps be said that the most general plan has been to issue a 6 per cent or 7 per cent preferred stock, preferred not only as to dividend named, but as to assets as well. In some cases the position of the preferred stock has been made exceptionally strong. Take, for example, the preferred stock of the Royal Baking Powder Company which, under the plan there followed, is allowed no voting power or representation in the management so long as the quarterly dividends of 6 per cent per annum are regularly and promptly paid. But if there should be a default in the payment of that dividend, the entire voting power and management pass from the common to the preferred stockholders. This provision thus leaves the preferred stockholders in much the same position as if their interest was represented by bonds--but without the difficulty, expense and delay of foreclosure in case of default in payment of interest.

In the most of the recent consolidations there has been included no bonded debt. This I believe to be wise, inasmuch as it leaves the company with no fixed charges and thus in a much

stronger position in a period of depression than it would occupy if it were obliged to meet the interest on a large amount of bonds. Because of this infrequent use of bonds in the consolidations which have been made in the industrial field, the first long continued period of depression will not produce the abundant crop of reorganizations that has in the past attended depression in the railroad field.

In the issue of common and preferred stocks in the capitalization of the corporations we are considering, an attempt has frequently been made to limit the preferred stock to the value of the actual tangible assets turned over to the new company, real estate, plants, tools, machinery, stocks of goods, working capital, etc., leaving the common stock to cover the value of the good-will, expected earnings, expenses of promotion, etc. This brings up a question which is of much importance to those who invest in the new company's stock, viz.: "In what manner has the value of this good-will been estimated in fixing a price upon the various constituent companies?" Nearly every proposition for a consolidation has been accompanied by the results of a careful investigation into the net earnings of the constituent companies for a number of years past. These earnings, augmented, perhaps, by an estimate of the economies to be effected by the consolidation of the various enterprises, form the basis of the estimated net earnings of the new company. Care is then taken that the capital stock is not made so large that the estimated earnings will not afford the dividend upon the preferred stock and a substantial dividend upon the common stock.

In some cases the value of the good-will acquired has been very carefully estimated. For example, the promoters of one company made a special point of the conservative methods employed in arriving at the value of the goodwill of the companies which were consolidated. According to their statement the new company was virtually buying the real estate, plants, stock, etc., on the basis of appraised cash value. In addition an allowance was made for good-will, calculated upon this basis: From the net profits of each company deduct 7 per cent upon the capital actually employed, 1½ per cent upon sales, which were about three times the capital, 2 per cent for depreciation on brick buildings, 4 per cent on frame buildings, and 8 per cent on machinery; if the average net earnings were in excess of all this, and in this case it appeared from the promoter's statement that they usually were, the excess was capitalized as good-will on the basis of 20 per cent per annum, i.e., the value of the good-will was estimated to be five times the amount of such earnings in excess of 7 per cent on capital and allowance for depreciation.

In some cases, however, there has not even been a pretext that the capitalization was based upon a careful investigation of the actual earnings of the constituent companies. I have in mind a certain consolidation which it was desired to effect. The promoters and the brokers who attempted to bring it out, however, in their prospectuses carefully avoided the subject of actual net earnings of the constituent companies, but based the estimate of earnings of the new company upon nothing more reliable than the quantity of product annually turned out and an estimate that the selling price had been and would be about twice the cost of producing the article. It is hardly to be wondered at that the project was not sufficiently attractive to enlist the necessary investment support.

Many of these large industrial corporations have been formed to purchase, not the actual plants and assets, but the whole or a large part of the stock of the constituent companies. This stock even when the whole is owned by the new corporation, is then kept alive and constitutes the formal assets of the new company.

I might describe all the steps taken in the formation of the corporation, were there time; but it is only what is done in the formation of a corporation for any purpose, and, while interesting, does not belong especially to this subject.

I have a table of the kinds and amounts of the securities used by some of the more important of the 200 or 300 corporations of this nature that have been formed within the past few years. (This table is shown on page 285.)

All this that I have described which is in excess of what is done in the formation of the cheese manufacturing combination is rendered necessary either by the state laws governing corporations or by the need of raising cash capital, or to enable the constituent members of the corporation to conveniently collect their profits from the combined business in proper proportions and to have a representation of their interests therein which is divided in such form as to enable portions of it to be sold or transmitted to heirs, etc., etc.

In substance, however, there is no difference. The milk delivered morning and evening during the year is each farmer's contribution to the combination; his interest in the whole varies according to both quality and quantity of milk, just as in the other combinations the interests vary according to the quality and quantity of property and good-will or business contributed by each. Just as a creamery will be successful as it is well or badly managed, or as is the market for its products, so in like proportion will any other business combination succeed, and for like causes.

The larger combinations, however, through their securities affect financial matters generally to a greater or less extent as they come into the stock market and into the field of investment and speculation. Naturally the uncertainty as to amount and regularity of profits attendant upon one of these enterprises while it is new will make its securities a fruitful object of speculation. Time and experience will soft them and cause each one to take its proper place in the share list. All other business securities, be they railroad, telegraph, bank stocks or whatnot, have and must go through a like sifting and settling process and their values are and will be constantly changing. Some of the other industrials, as they are called, have come to be as regular in their dividends and as stable in price as the best railroad stocks, and some of them are much more removed from the speculative field.

CAPITALIZATION OF SOME OF THE MORE IMPORTANT INDUSTRIAL TRUSTS.

	Common Stock.	Preferred Stock. Amount.	Rate.	Character.	Bonds. Amount.	Rate.
Common Stock only:						
Amalgamated Copper Co	$75,000,000					
Diamond Match Co.	15,000,000					
Standard Oil Co., of N.J.	100,000,000					
Preferred and Common Stock:						
[illegible]	[illegible]					
Am. Agricultural Chemical Co.	16,500,000	$16,500,000	6	C.A.		
American Beet Sugar Co.	15,000,000	4,000,000	6	NC.		
American Brick Co.	7,500,000	7,500,000	7	NC.		
American Bridge Co.	34,500,000	23,000,000	7	CA.		
American Car and Foundry Co.	29,090,000	29,090,000	7	NC.A.		
American Chicle Co. (chewing gum)	6,000,000	3,000,000	6	C.		
American Ice Co.	22,939,100	12,440,400	6	C.		
American Linseed Oil Co.	15,475,000	15,475,000	7	NC.		
American Malting Co.	14,500,000	14,440,000	7	C.		
American Radiator Co.	5,000,000	3,000,000	7	C.		
American Smelting and Refining Co.	27,400,000	27,400,000	7	C.		
American Steel Hoop Co.	19,000,000	14,000,000	7	C.A.		
American Steel and Wire Co.	50,000,000	40,000,000	7	C.		
American Sugar Refining Co.	36,968,000	36,968,000	7	C.		
American Tin Plate Co.	28,000,000	18,000,000	7	C.		
American Tobacco Co.	54,500,000	14,000,000	8	NC.A.		
American Window Glass Co.	13,000,000	4,000,000	7	C.		
American Woolen Co.	29,501,100	20,000,000	7	C.		
Continental Tobacco Co.	$48,846,100	$48,844,600	7	NC.A.		
Distilling Company of America	46,250,000	31,250,000	7	C.		
General Chemical Company	12,500,000	12,500,000	6	C.		
Glucose Sugar Refining Co.	24,027,300	12,619,300	7	C.		
Havana Commercial Co.	10,000,000	6,000,000	7	C.		
International Car Wheel Co.	3,225,000	1,775,000	7	CA.		
International Power Co.	7,400,000	600,000	3	C.		
International Steam Pump Co.	15,000,000	8,850,000	6	C.		
National Biscuit Co.	29,200,000	23,200,000	7	C.		
National Lead Co.	14,905,400	14,904,000	7	C.		
National Salt Co.	3,500,000	2,400,000	7	NC.		
National Steel Co.	32,000,000	27,000,000	7	C.A.		

	Common Stock	Preferred Stock Amount	Preferred Stock Rate	Character	Bonds Amount	Bonds Rate
National Tube Co.	40,000,000	40,000,000	7	C		
National Wall Paper Co.	27,931,500	7,500,000	8	Debenture Stock		
Otis Elevator Co.	6,000,000	4,000,000	6	NC.		
Republic Iron and Steel Co.	27,352,000	20,852,000	7	CA.		
Royal Baking Powder Co.	10,000,000	10,000,000	6	CA.		
Rubber Goods Manufacturing Co.	12,114,900	6,336,900	7	C.		
Union Bag and Paper Co.	16,000,000	11,000,000	7	CA.		
Union Typewriter Co.	10,000,000	(1st) 4,000,000	7	C.		
		(2d) 4,015,000	8	C.		
United Shoe Machinery Co.	8,660,725	8,657,700	6	C.		
United States Rubber Co.	23,666,900	23,525,500	8	NC.A.		
Stock and Bonds:						
American Bicycle Co.	20,000,000	10,000,000	7	C.	10,000,000	5
American Cotton Oil Co.	20,237,000	10,198,600	6	NC.	3,068,000	8
American Hide and Leather Co.	11,500,000	13,000,000	7	CA.	8,445,000	6
American Writing Paper Co.	9,500,000	12,500,000	7	CA.	17,000,000	5
American Thread Co.	6,000,000	6,000,000	5	---	6,000,000	4
Asphalt Company of America	30,000,000	.....	..	---	30,000,000	5
Central Foundry Co.	7,000,000	7,000,000	7	C.	4,000,000	6
Federal Steel Co.	46,484,300	53,261,000	6	NC.A.	28,334,000	5
International Paper Co.	17,442,800	22,406,700	6	C	8,782,000	6
International Silver Co.	9,946,000	5,111,500	7	C	3,592,000	6
					(7,000,000	6
Mt. Vernon--Woodbury Cotton Duck Co.	9,500,000	.....	..	---	(6,000,000	Inc 5
National Starch Manufacturing Co.	4,450,700	(1st) 2,219,400	8	CA.	3,042,000	6
		(2d) 1, 846,800	12	CA.	5,700,000	5
New England Cotton Yarn Co.	5,000,000	5,000,000	7	CA.		
Standard Rope and Twine Co.	12,000,000	.....	..	---	(2,878,000	6
					(7,500,000	Inc 5
United States Envelope Co.	750,000	3,750,000	7	C.	2,000,000	6
United States Flour Milling Co.	3,500,000	5,000,000	6	C.	7,500,000	6
United States Leather Co.	62,854,600	62,254,600	8	C.	5,280,000	6

C - Cumulative
NC- Non-cumulative

A-Preferred as to assets as well as dividends.
Inc--Income bonds.

The Distribution of Securities in the Formation of the United States Steel Corporation

During the period from 1898 to 1901, when the formation of industrial consolidations was most active, comparatively little attention was given, either by the promoters, the underwriters or the owners of the constituent properties, to the important economic problems connected with the effects of the various consolidations upon the relative status of the parties in interest. In certain cases complaints were made in conferences, and occasionally in the financial press, that the owners of important plants were unfairly treated in the distribution of securities, but in general the answer to such charges, "If you don't like the terms you can stay out," was considered a sufficient justification for any plan that proved acceptable to a sufficient number of interested parties to ensure its adoption.

Attention in a large way was first called to the seriousness of the problem in the Harriman suit against the Northern Securities Company, the Harriman interests asking for the return of the securities exchanged for Northern Securities stock, rather than a pro-rata distribution as proposed by the directors and approved by the stockholders. After the case had been exhaustively argued, the Supreme Court refused to sanction the petition of the Harriman interests for several reasons--one of them being the difficulty of preserving the equities in the situation between the Hill-Morgan and the Harriman groups by the use of the direct-return method. The pro-rata method was approved, one of the important reasons being that in this way all parties at interest must of necessity receive an equitable interest in the several independent companies created by the order for distribution. The continued success of the United States government, acting through the Department of Justice and the courts, in forcing the dissolution of many of our more important consolidated corporations, has given more than an academic interest to the problems necessarily connected with the equitable distribution of securities, both in the process of formation and in that of disintegration.

Already the Northern Securities Company, the powder consolidation, the Standard Oil Company and the American Tobacco Company have been disintegrated and their securities distributed by the pro-rata method on order of the Supreme Court. A decision against the Harvester Trust has been rendered and its dissolution is now in process. The suit of the United States government against the United States Steel Corporation, asking for its dissolution, is being expedited under the law with all possible speed. Several other cases are either before the courts or have been settled without litigation by conferences between the representatives of the corporations and of the government. Under these circumstances a more exact knowledge of the process by means of which consolidations are formed is a necessary prerequisite to an understanding of their economic effects upon shareholders, whether such aggregations of capital are permitted to remain intact or are forced to disintegrate by order of the courts.

I

In general there are three fairly well defined methods in more or less common use for the distribution of securities in the formation of consolidations. The first in practical importance may be called the bargain method; the second, the Moore method; the third, the scientific method.

of Securities in the Formation of the United States Steel Corporation

[illegible] from 1898 to 1901, was the formation of [illegible] in the economics, the activities or the [illegible] consistency [illegible], some improvement [illegible] noted with the efforts of the various combinations [illegible] active studies of the results in interest. In certain [illegible] were made in confidence, and consciously in the [illegible] that the owners of important plants were [illegible] distribution of securities, but in general the [illegible] "If you don't like the terms of one s.cv [illegible] offered a sufficient guarantee of it for any plan that [illegible] tools to a sufficient number of interested entities to [illegible].

[illegible] in a large way was filer called to the assistance of [illegible] in the Western in spite the Northern Securities [illegible] the Wall Street in spite [illegible] a ability for the return of the securities [illegible] for Northern Securities stock; rather than a one-time dis- [illegible] proposed by the directors and approved on the stock- [illegible]. After the case had been successfully argued, the [illegible] to accepting the decision of the Supreme Court [illegible] for [illegible]--one of their being the difficulty of securing [illegible] in the attempt between the high-strung and the [illegible] by the use of the [illegible]-return method. The [illegible] [illegible] + [illegible] [illegible] to [illegible] at interest but [illegible] necessary receive an equitable [illegible] several independent companies created by the order [illegible]. The continued success of the United States [illegible] through the Supreme Court of Justice and the country, in [illegible] resolution of many of our more important controversies [illegible] has given more than economic interest to the [illegible] [illegible] ly connected with the [illegible] distribution of [illegible] in the process of formation and in that of [illegible].

[illegible] by the Northern Securities Company, the Powder Consolidation- [illegible] Standard Oil Company and the American Tobacco Company have [illegible] and with [illegible] distinctness by the [illegible] [illegible] of the Sherman Act. A decision against [illegible] or Trusts has been rendered and its dissolution is now in [illegible] the suits of the United States government against the United [illegible] Corporation, [illegible] for its dissolution, is being [illegible] law with all possible speed. Several other [illegible]

[illegible] between the representatives of the corporations [illegible] of the problems by means of which consolidations are [illegible] easy [illegible] to an understanding of [illegible] [illegible] to remain intact or are forced to dissolve- [illegible] the courts.

I

[illegible] fairly well defined methods in [illegible] distribution of securities in the formation- [illegible] a practical interference may be [illegible]

When operating under the first plan, the promoter provides for a maximum of securities to be issued by the central corporation and then enters into contracts or agreements to exchange the securities authorized for the securities of the companies which it is hoped to consolidate into one company on the best terms possible. The more favorable the rate of exchange in any particular case, the larger the share of securities which will remain in the hands of the promoter. Since some of the owners of the various properties included in the plan of consolidation are shrewder at bargaining, or more favorably situated for independent action, it necessarily follows that those thus situated invariably obtain in the distribution of securities a larger interest in the consolidation than the intrinsic value of their plants would justify.

The Moore method was devised by Mr. W. H. Moore and was used by the Moore brothers, W. H. and J. H., in the American Tin Plate Company, the American Sheet Metal Company and several other consolidations promoted by them during the period of active consolidation. The first step in the Moore plan is to secure cash options on all the properties that are considered desirable for the consolidation, so far as such options can be obtained at acceptable figures. A plan for the financial organization of the consolidation is then prepared. Next, arrangements are made with underwriters to supply the necessary funds to take up all the options at the appropriate time, or such portion thereof as the promoter judges will be required. Finally, each owner of securities in the companies on which cash options are held is offered cash or securities in the new corporation at his option. If all the option-givers should choose to take their pay in cash, there would necessarily be required large resources in ready funds to ensure the success of the promoter's plan. Generally, however, the option-givers have preferred to take securities, and the promoters using this method have so arranged their financial plans as to favor this inclination. According to the report of the Industrial Commission, it was customary to offer each of the option-givers seven per cent cumulative preferred stock equal in amount to the face value of the cash option, and a like amount of common as a so-called "bonus." The offer of the promoters to give two hundred dollars' worth of stock instead of one hundred dollars in cash appeared so attractive, on its face, that the owners generally took the securities rather than the cash. The requirement for cash was thus reddced to a small fraction of the values involved in the deal. It was usual, as would be expected, for the promoter to issue common stock in liberal quantities, and the total amount in excess of the preferred was retained in his own hands as a reward for his services. In the case of the American Tin Plate Company, 10/28 of all the common stock issued was thus retained.

The third method, denominated the scientific, exists in the world of finance as an ideal rather than as an actuality. Briefly, it consists in issuing securities to the owners of the constituent properties in exchange for their interests in such a way that each will receive his proportionate share in the increased earnings in case of success, and share also his proportion of the losses in case of failure. This object is accomplished by issuing (1) preferred stock equal in face value to the tangible assets with such dividend rate, conditions of issue and of redemption as will make its market value equal its face value, and (2) common stock in proportion to the surplus earnings contributed by each company over and above the requirements for the preferred. To find the amount

of preferred and common to be issued and assigned to the several owners, it is necessary (1) to make an appraisal of the tangible assets of each of the companies, keeping the results separate, and (2) to have an accounting for the purpose of ascertaining the net earnings of each of the several companies, extending over a period of years sufficiently long to be representative of actual earning power. The common stock may be issued to any convenient amount, preferably slightly exceeding the preferred, so that control of the corporate policy of the central corporation will be in the hands of those holding the contingent interests. The important questions connected with the common stock relate to its distribution. To illustrate: it is proposed to consolidate two companies, A and B, with assets and earnings as follows:

	Net Assets	Net Earnings	Rate Per Cen
A.	$10,000	$1,500	15
B.	20,000	2,000	10

Company C is organized with $30,000 7 per cent cumulative preferred stock and $40,000 common stock. Stockholders in Company A are allotted $10,000 of the preferred stock and the remaining $20,000 is assigned to the stockholders of Company B. The promoter, it may be assumed, will retain $10,000 of the common stock to pay the organization expenses and as compensation for his services. The remaining $30,000 of common stock will be divided as follows:

	Net Earnings	Requirements For Preferred	Excess Earnings	Common
A	$1,500	$ 700	$800	$17,143
B	2,000	1,400	600	12,857
				$30,000

Under this method of distributing securities, the owners of the constituent companies will share in the earnings in case of continued operation in the same proportions as before the consolidation took place, and, provided the promoter has been allotted stock only for actual benefits conferred by his efforts, in the same amounts. In case of dissolution, on the other hand, the former owners will receive in the distribution of assets in proportion to the value of the tangible assets contributed. In either contingency, the relative economic positions of the parties at interest will be maintained on a parity.

II

The relative merits of these three plans will appear more clearly from an examination of the results which would flow from their adoption in the formation of an actual consolidation. The United States Steel Corporation affords an excellent opportunity for such a comparison.

This corporation, a holding company, was formed in March, 1901, by the consolidation of the following corporations: the Carnegie Company of New Jersey, the Federal Steel Company, the American Steel and Wire Company, the National Tube Company, the National Steel Company, the American Tin Plate Company, the American Steel Hoop Company, and the American Sheet Steel Company. Later in the same year the Steel Corporation, by an exchange of stock, acquired control of three other companies: the American Bridge Company, the Lake Superior Consolidated Iron Mines, and the Shelby Tube

Company. It also purchased outright a one-sixth interest in the Oliver Mining Company and the Pittsburgh Steamship Company, and the Bessemer Steamship Company. In addition to the above companies, all of which became constituent parts of the United States Steel Corporation in the spring of 1901, the steel corporation acquired control of the Union Steel Company in 1903, the Clairton Steel Company in 1 04, and the Tennessee Coal, Iron and Railroad Company in 1907.

These companies belonged to two distinct groups: (1) those producing crude and semi-finished steel for the trade and the heavier finished steel products, and (2) those using the semi-finished steel for the purpose of manufacturing articles for more direct consumption. In the former group were the American Tin Plate Company, the American Steel and Wire Company, the National Tube Company, the American Steel Hoop Company, the American Sheet Steel Company, the American Bridge Company, and the Shelby Tube Company. The remaining companies, acquired in the spring of 1901--the Lake Superior Consolidated Iron Mines Company and the Bessemer Steamship Company--were engaged in mining iron ore and transporting it down the Great Lakes to the iron and steel mills of the Pittsburgh and Chicago districts.

From the financial point of view the above-named companies represented, before the consolidation, five distinct groups of interests, as follows: (1) The Morgan group, including the Federal Steel Company, the National Tube Company, and the American Bridge Company; (2) the Moore group, including the National Steel Company, the American Tin Plate Company, the American Sheet Steel Company, and the American Steel Hoop Company; (3) the Carnegie group, owning the Carnegie Company and its subsidiary interests, including the Frick Coke Company, the Bessemer and Lake Erie Railroad, and certain steamship lines and docking facilities on the Great Lakes; (4) the Rockefeller group, owning the Lake Superior Consolidated Iron Mines Company, with large holdings of iron mines in the Lake Superior district and certain railway and steamship lines built and acquired for the purpose of facilitating the transportation of the crude ore to the market; (5) the Gates group, controlling the American Steel and Wire Company and its affiliated interests.

The consolidation movement in the iron and steel industry began as early as 1889, when the Illinois Steel Company, later a constituent part of the Federal Steel Company, was formed by the union of two companies, the North Chicago Rolling Mill Company and the Union Steel Company, and soon after acquired the property of a third, the Joliet Steel Company. This merger was followed in 1891 by the consolidation of the Lackawanna Iron and Coal Company and the Scranton Steel Company into the Lackawanna Iron and Steel Company. At about the same time Laughlin and Company, Ltd., and Jones and Laughlin, Ltd., united to form the well-known Jones and Laughlin Company. In 1892, two important steps in the consolidation movement were effected: first, the organization of the Carnegie Steel Company, Ltd., a partnership bringing into closer and more efficient union the Carnegie and Frick properties and the various affiliated companies which they had been acquiring during the previous decade; second, the formation of the Consolidated Steel and Wire Company, a union of three competing companies, which later formed the center of the American Steel and Wire Company when the latter company was promoted in 1899.

During the period from 1893 to 1898, the years of the panic and those immediately succeeding it, there was almost no change in the financial organization of the various steel and iron companies. In the year 1896 an event of the profoundest importance occurred--the execution of a contract between the Carnegie Steel Company and the Lake Superior Consolidated Iron Mines Company, by which the latter agreed to furnish at a royalty of 25 cents per ton a considerable portion of the former's requirements. This partial union of the Carnegie and Rockefeller interests was everywhere regarded as a formal declaration on the part of the former that they were prepared for any competition that might arise. The step just referred to was followed by others of the same general nature, and in the course of the next two years the Carnegie Company secured control by lease of a large reserve iron-ore tonnage. The Engineering and Mining Journal, in commenting on the situation, remarked that "we have had pools and combinations without number in the iron market in this country but never before a position like this, in which a single company could absolutely dominate the trade and make any combination which can be formed simply the register of its own wishes." The Carnegie-Rockefeller contract was followed in 1898 by the formation of the first of the great consolidations--the Federal Steel Company--a company uniting the Illinois Steel Company previously referred to, the Minnesota Iron Company, with large holdings of iron ore and extensive transportation properties, the Lorain Steel Company of Ohio, the Johnstown Steel Company of Johnstown, Pa., and the Elgin, Joliet and Eastern Railway. During the years 1899 and 1900, the Moore brothers, W. H. and J. H., formerly connected with the Diamond Match Company, entered the field as the promoters of four companies known as the Moore group, which comprised the National Steel Company, the American Tin Plate Company, the American Steel Hoop Company, and the American Sheet Steel Company. The first company manufactured crude steel and heavy steel products; the other three were important consumers of the above products. During the same period the remaining Morgan companies were organized--the first, the National Tube Company in June, 1899, the second, the American Bridge Company in 1900, each being made up of a considerable number of formerly competing companies. As to the two other companies which entered the steel corporation, the Carnegie Company, while not a consolidation in the ordinary sense, had for many years been buying up competitors and integrating many of the companies which it found convenient as furnishers of raw materials, while the Shelby Tube Company was a fairly complete consolidation of the leading manufacturers of seamless tubing. It was, however, dependent upon the manufacturers of crude steel for the material which formed the basis of the drawn tubing.

The formation of the several steel companies above described was, however, but a first step in the consolidation of the steel industry. Almost immediately after the fundamental consolidations were effected, the natural effects of such a movement began to be felt. First, the National Tube Company began the erection of blast furnaces, thus depriving the Carnegie Company of one important consumer of billets and other heavy raw materials used in the manufacture of tubing. The Carnegie Company had for some time been planning extensions, and as a direct result of the action of the National Tube Company it was decided to erect a modern plant at Conneaut Harbor, where it was thought the cost of manufacturing would be reduced to a minimum. Second, as a result of a long-standing controversy between the Pennsylvania Railroad and the Carnegie Company over rates, the latter had determined to build a new, low-grade, short-line railroad from Pittsburgh to tidewater via the Western Maryland Railroad. The plans as proposed called for the

construction of 156 miles of railroad connecting the Union Railroad with the Western Maryland at Cumberland, thus freeing Pittsburgh from the monopoly of the Pennsylvania, and giving the district, as Mr. Carnegie said, "competition of railroads." Third, early in the fall of 1899, Mr. Charles M. Schwab of the Carnegie Company spoke before a company of distinguished business men in New York city on the advantages of consolidation in the manufacture and marketing of steel. Morgan sat at his right and among the men present were Harriman, Carnegie, Phipps and seventy or eighty others. Fourth, Mr. Morgan, whose tube plant was threatened by the plans of the Carnegie Company and whose interest in railroads was a dominant factor in all his plans, began to give the situation more serious attention. According to both Mr. Gates and Mr. Schwab, Mr. Morgan discussed the situation with the former and then, through the instrumentality of Mr. Gates, sent for Mr. Schwab for the purpose of going over the project in detail. A meeting was arranged and the matter was discussed at considerable length and after a day or two Mr. Morgan, having been convinced of the desirability of the project, requested Mr. Schwab to see Mr. Carnegie and to obtain a price on the Carnegie properties. This was done within a few weeks, the price set being $420,000,000, payment to be made in cash or five per cent bonds. Mr. Morgan then consulted Mr. Gary. After a full discussion of the plan, a conference was arranged with the principal directors in the Federal Steel Company, including Ream, Rogers, Mills, Porter and Field. Here again the desirability and practicability of the proposed consolidation was carefully considered and after such consideration, despite the opposition of Mr. Porter and others, the project was affirmed and Mr. Morgan consented to act as the manager of an underwriting syndicate to furnish the financial backing that was required. As a result the United States Steel Corporation was formed under the New Jersey law on the 25th of February, 1901, and on the 28th of the same month the Morgan Syndicate was formally organized by a group of financiers, including Mr. Morgan, the leading men connected with the several steel companies which it was planned to unite, and several others. The plan under which the steel industry was consolidated was prepared within a comparatively few days and on March 1, 1901, was submitted to the directors of the United States Steel Corporation at their second meeting and duly approved.

The plan provided for the increase of the capital stock of the steel corporation from $3000, the amount originally authorized, to an aggregate issue of $424,998,500 of preferred stock, the same amount of common stock, and $304,000,000 of five per cent bonds of such form, tenor and security as J. P. Morgan and Company should determine. The entire amount of capitalization provided, included the bonds, was to be transferred to the syndicate in exchange for the entire bond issue of the Carnegie Company, all the shares of the capital stock of the eight companies included in the consolidation, the statutory fees and taxes connected with the issuance of the new securities, and $25,000,000 in cash. The syndicate was allowed until May 30, 1901, to complete the exchange and the entire agreement was contingent upon the ability of the syndicate to deliver at least fifty-one per cent of the common and preferred stock of each of the companies. If the syndicate should fail to deliver all of the capital stock of each of the companies and all of the bonds of the Carnegie Company, the following allowances were to be made:

Name of Company and Class of Stock	Amount of stock to be deducted in par value	
	Preferred Stock	Common Stock
Carnegie Company, common stock.	$150,00	$150.00
Federal Steel Company:		
Preferred stock	110.00	
Common stock	4.00	107.50
American Steel and Wire Company of New Jersey:		
Preferred Stock	117.50	
Common stock		103.50
National Tube Company:		
Preferred stock	125.00	
Common stock	8.80	125.00
American Tin Plate Company:		
Preferred stock	125.00	
Common stock	20.00	125.00
American Steel Hoop Company:		
Preferred stock	100.00	
Common stock		100.00
American Sheet Steel Company:		
Preferred stock	100.00	
Common stock		100.00

In accordance with the terms of the underwriting agreement, J. P. Morgan and Company, as syndicate managers, issued on March 2, 1901, a circular letter addressed to the stockholders of the eight companies, stating the conditions under which the underwriting was to be carried out, calling attention to the expected advantages of the consolidation and offering to exchange stock in the United States Steel Corporation for stock in the several companies at the rate of exchange named in the underwriting agreement. The circular letter appeared as an advertisement in the daily press as well as in the financial journals and on March 21, 1901, public announcement was made by the syndicate managers that a very large proportion of all the stocks had been exchanged and that the projected consolidation was consummated.

Even while the exchange of stock between the United States Steel Corporation and the eight companies was being effected, it was proposed by those connected with the active management to extend the scope of the consolidation by acquiring control of six other companies. This proposition was presented to the board of directors on March 30, 1901, duly approved, and their action was confirmed by the stockholders of the original $3000 United States Steel Corporation on April 1. Immediately thereafter a second underwriting agreement was entered into between Morgan and Company and the United States Steel Corporation by which it was agreed to increase the capital stock of the corporation and to exchange the new shares for the capital stock of the following companies on the terms named in the table at the top of page 211-212.

The second part of the consolidation in accordance with the above plan, with the exception of the Colorado Fuel and Iron Company, was effected without apparent difficulty during the month of April, 1901, the capital stock having been further increased to $1,100,000,000, one-half preferred and one-half common, for the purpose of making the exchange of stock on the terms proposed in the agreement.

	Preferred Stock	Common Stock
[illegible]	$140.00	[illegible]
[illegible]	110.00 4.00	[illegible]
[illegible]	117.50	[illegible]
[illegible]	125.00 5.50	[illegible]
[illegible]	120.00 [illegible]	[illegible]
[illegible]	100.00	[illegible]
[illegible]	140.00	[illegible]

Companies	For Each Share Par Value $100 in U.S. Steel Securities	
	Preferred	Common Stock
American Bridge Company:		
Preferred.	110	
Common		105
Shelby Steel Tube Company:		
Preferred.	37.5	25
Lake Superior Consolidated Iron Mines Company:		
Common.	135	135
One-sixth interest in Oliver Iron Mining Company and the Pittsburgh Steel Company	92,500 shares $8,500,000 in cash	92,500 shares

The results of the plan, after all of the exchanges had been made, are shown in table at the end of this reading.

III.

Neither at the time that the United States Steel Consolidation was formed nor at any time since then, so far as the writer has been able to discover, has an explanation been made of the principle or principles upon which the exchange of securities was based. In the case of the four Moore companies an exception to the above statement ought to be made, for while no clue is given to the distribution of securities as between the Moore Companies and all the others, it is stated in the official announcement that the aggregate amount of stock to be offered to the four companies was distributed among them in the percentages given in the public circular, in accordance with arrangements made with the principal stockholders.

It is evident, however, even without a careful analysis, that neither the Moore method nor the scientific plan described in the preceding sections was followed. If the latter plan had been adopted, not only would the various interests which were combined into one single administrative business unit have been placed upon a parity in the new company, but in addition the capitalization of the United States Steel Corporation would have been much less watered than was the case.

It will be remembered that the scientific plan is based upon two principles: first, preferred stock to be issued equal to the value of the tangible assets; and second, common stock of an equal or larger amount but distributed among the several parties to the consolidation in proportion to the surplus earnings after the preferred dividends have been provided for. Consequently in the formulation of a scientific plan, two series of facts are necessary, (1) the net tangible assets of the several companies, properly valued, and (2) the net profits of each for a period of time sufficiently long to be fairly representative of actual earning power. It is evident that the promoters, at the time the steel consolidation was in process of formation, were in possession of the requisite data, although the records do not show to what extent the printed reports of the several companies were subjected to examination by the expert staff of appraisers and accountants connected with the Morgan office. In presenting the plan of consolidation to the directors of the United States Steel Corporation, Mr. Steele stated

in behalf of the Morgan Syndicate that "the principal officers of the Carnegie Company have satisfied us that the net earnings of the properties which are now included in the Carnegie Company for the year 1900 are upwards of $40,000,000," and that the earnings of the American Sheet Steel Company for ten months ending January 31, 1901, were "$850,000 after making a substantial allowance for depreciation and investments in improvements." In addition he submitted for the information of the directors the printed reports of all the companies except the Carnegie Company. As a result of the investigations of the Bureau of Corporations there is, however, fairly reliable information as to the respective assets of the several companies at the time of the consolidation and some data, though far from satisfactory, as to their respective earnings. The available information as to the assets at the date of consolidation and the earnings of the several companies for periods specified in the footnotes is given in the following table:

Assets and Earnings of the Consolidated Companies

Company	Estimated Value of Tangible Assets	Market Value of Assets	Stated or Estimated Net Earnings
Carnegie Company	$197,563	$327,422	$40,000
Federal Steel Company . . .	81,147	63,940	11,722
National Tube Company . . .	67,485	57,168	13,878
National Steel Company. . .	33,909	37,931	8,750
American Tin Plate Company.	24,503	25,370	5,850
American Sheet Steel Company.	17,706	30,895	1,680
American Steel Hoop Company .	15,661	16,928	4,026
American Steel & Wire Company.	53,162	59,884	12,362
American Bridge Company. . .	35,404	42,773	6,201
Lake Superior Consolidated Iron Mines Company	31,495	22,060	6,668
Shelby Steel Tube Company	2,791	3,571	222
Oliver Iron Mining Company and Pittsburgh Steel Company, one-sixth	9,250	9,250	264
Bankers' Investment.	25,003	25,003	4,986
	$595,079	$712,193	$116,578

The method of obtaining the estimated value of the tangible assets of the several companies is explained at length in the report of the Commissioner of Corporations on the Steel Industry. As a rule, the valuation placed upon the tangible assets appears to be fairly liberal. In most cases, much dependence was placed upon the valuations determined upon in connection with the primary consolidations which occurred during the years immediately preceding 1901. Additions were made for cash contributions to the working capital and deductions were allowed wherever it appeared from an examination of the accounts or tangible assets that there had been an over-valuation. The market valuation was computed by taking the average market price of the several securities as found by the commissioner of corporations and multiplying by the total amount of outstanding securities, of each class separately, and combining the results for each company as a unit. Some of the securities were distinctly of the stock-exchange variety and these were undoubtedly given a somewhat artificial valuation. The securities of others, as for example the Carnegie Company and the Lake Superior Consolidated Iron Mines Company, were closely held and the market quotations were probably more conservative and perhaps less representative. As a whole, however, the market valuation

is probably more nearly representative than the estimated value placed upon the tangible assets.

In obtaining the approximate net earnings of the several companies, various sources of information have been used and in general the source in each case is indicated in the footnotes to the table. It should be stated at the outset that the information upon this subject is extremely meagre and always unsatisfactory, if not unreliable. In some cases the earnings for 1899 were adopted, in others 1900, and in still others a combination of parts of the two years. Where no information was obtainable, the companies have been arbitrarily assigned an earning power equal to that which was shown in the ten years immediately following the consolidation. Since the earnings as well as the value of the tangible assets are used in distributing the securities in a consolidation formed upon equitable principles, it is evident that the results of such application will be unsatisfactory in proportion as the stated earnings fail to conform to actual conditions. The results obtained by their use are, in other words, vitiated by the probable errors in the hypothesis, and are therefore submitted as indicative of certain tendencies in promotions and illustrative of a proper plan of consolidation, rather than as statements of facts.

With the above explanations in mind and subject to the limitations imposed by the unsatisfactory data, it may prove illuminating to apply first the plan proposed in the preceding pages, second, that adopted by the Moore Brothers in their several promotions and known generally as the Moore method, to the facts in hand.

Under the conditions as above stated, had the scientific method been followed, the stock in the United States Steel Corporation would have been issued in the quantities and to the several parties in interest as in the table immediately following:

Scientific Method
(Three ciphers (ooo) omitted except in last column.)

Company	Preferred Stock	Earnings	Dividends (7%) on Preferred	Surplus for Common	Common Stock
Carnegie Company	$197,563	$40,000	$14,829	$25,171	176,425,000
Federal Steel Company	81,147	11,722	5,680	6,042	42,348,950
National Tube Company	67,485	13,878	4,724	9,1 4	64,161,250
National Steel	33,909	8,750	2,374	6,376	44,689,980
Tin Plate	24,503	5,850	1,715	4,135	28,982,600
Sheet Steel	17,706	1,680	1,239	441	3,091,010
Steel Hoop	15,661	4,026	1,096	2,930	20,536,650
Steel and Wire	53,162	12,362	3,721	8,641	60,565,580
American Bridge Company	35,404	6,201	2,478	3,723	26,094,850
Lake Superior	31,495	6,668	2,305	4,463	31,281,580
Shelby Steel Tube	2,791	222	195	27	189,250
Oliver & Pittsburgh, one-sixth	9,250	264	647	deficit	
Bankers	28,003	4,896	1,760	3,146	22,050,610
Promoters (12.54636 per cent)	0	0	0	0	74660790
	$595,079		$42,653		$595,079,000
		$116,518		$74,249	

It is of course questionable whether the promoter, either from the economic or equitable point of view, is entitled to so large a share of the common stock as here awarded, namely, twelve per cent,

more exactly 12.54633 per cent. That question, however, is one between the promoter and the promoted interests and does not necessarily affect the relative shares allotted to the several companies involved. In this case the twelve per cent rule was followed because the promoters thus receive approximately the same proportion as they were awarded in the Morgan plan. If thirty per cent had been allotted to the promoter, as was the custom at that time, he would have received $178,524,000 of the common stock instead of the amount assigned, and the difference, somewhat over $100,000,000, would have been subtracted from the other interests in the same proportions as that already allotted. It should further be noted that five per cent first collateral trust gold bonds may be substituted for seven per cent preferred stock either partially or as a general plan without disturbing the established scheme or the method of distributing the common stock.

The Moore plan of distributing securities in forming a consolidation was used in the promotion of the American Tin Plate Company. Since for its application in the present case the market value only of the assets of the several companies is required, the results may claim to be fairly accurate. Here the promoter is allotted 35.71 per cent of the common stock, that being the relative amount that he received in the case of the promotion of the American Tin Plate Company. This would amount to $395,663,000 par value in common stock out of a total of $1,107,858,000. This amount at $32.17 per share would have yielded the sum of $127,231,950 in cash provided the promoter had sold out at the time, on prevailing market conditions. The plan worked out in detail is given in the table at the top of page 256.

It is evident that the adoption of a particular plan determines the relative share that each of the several companies is allotted in the new consolidation. Before an accurate comparison can be made, however, it is necessary to find a common unit of value for

The Moore Method

Name	Preferred	Per Cent	Common	Per Cent
Carnegie Company	$327,422	46.	$327,422	29.55
Federal Steel	63,940	9.	63,940	7.77
National Tube	57,168	8.	57,168	5.16
National Steel	37,931	5.3	37,931	3.42
Tin Plate	25,370	3.6	25,370	2.28
Sheet Steel	20,895	2.9	20,895	1.88
Steel Hoop	16,928	2.4	16,928	1.52
Steel & Wire	59,884	8.4	59,884	5.40
American Bridge	42,773	6.	42,773	3.86
Lake Superior	22,060	3.1	22,060	1.99
Shelby Steel Tube	3,571	.5	3,571	.32
Oliver and Pittsburgh, one-sixth	9,250	1.3	9,250	.83
Bankers	25,003	3.5	25,003	2.25
Promoter	..	..	395,663	35 71
	$712,195	100.	$1,107,858	100.

the several companies and by means of this unit reduce the securities to a common denominator and then compare the results. It is of course quite impossible to do this with scientific precision, but by the use of certain information that is available it is practicable

to reach an approximation of some value for our purposes. It was the evident intention of those responsible for preparing the plan actually adopted to make the conditions of issue and the relative quantities of securities provided for of such an amount that the bonds and preferred stocks would each be worth par while the common stocks were to be worth one-half of par.

As a matter of fact this assumption has been fairly well sustained by the market, although at times both the preferred and common have been far below the value set upon them by the promoters. Applying this principle to the securities as distributed by the Morgan plan, that is, rating the bonds and preferred stock at par and the common at one-half of par, the results are as indicated in the first table on this page.

Adjusted Distribution-Morgan Method

Name	Face Value Preferred & Bonds	One-Half Par Value of Common	Total Value Awarded	Per Cent
Carnegie Company	$402,277	$45,140	$447,416	41.87
Federal Steel	60,446	24,985	85,432	7.99
National Tube	53,520	25,000	78,520	7.35
National Steel	33,750	20,000	53,750	5.03
Tin Plate	28,506	17,500	46,006	4.30
Sheet Steel	24,500	12,250	36,750	3.44
Steel Hoop	14,000	9,500	23,500	2.20
Steel and Wire	47,000	25,625	72,625	6.80
American Bridge	34,511	16,249	50,760	4.75
Lake Superior	39,723	19,862	59,585	5.58
Shelby Steel Tube	1,875	1,019	2,894	.27
Oliver & Pittsburgh, one-sixth	9,250	4,625	13,875	1.29
Bankers & Promoters	65,000	32,500	97,500	9.12
Total	$ 814,358	$252,255	$1,068,613	100.

This plan thus places a total value of $1,008,613,000 upon the consolidated company, and this fact must be borne in mind in applying the general principle involved to the other cases. In the Moore method, the total par value of the preferred stock was fixed at $712,193,000. The common stock would then represent a value of $356,-418,000 or $32 plus, per share. The details of this plan are presented in the first table on the next page.

Adjusted Distribution--Moore Method

Name	Face of Preferred	32.17181 Per Cent Common	Total Value Awarded	Per Cent
Carnegie Company	$327,422	$105,337.58	$432,759.58	40.49
Federal Steel	63,940	20,570.66	84,510.66	7.81
National Tube	57.168	18,391.98	75.559.98	7.07
National Steel	37,931	11,203.09	50,134.09	4.69
Tin Plate	25,370	8,161.99	33,531.99	3.15
Sheet Steel	20,895	6,722.31	27,617.31	2.58
Steel Hoop	16,928	5,446.04	22,374.04	2.09
Steel and Wire	59,884	19,265.77	79,149.77	7.41
American Bridge	42,773	13,760.85	56,533.85	5.29
Lake Superior	22,060	7,097.11	29,157.11	2.74
Shelby Steel Tube	3,571	1,148.86	4,719.86	.44
Oliver & Pittsburgh, one-sixth	9,250	2,975.89	12,225.89	1.14
Bankers	25,003	8,043.92	33,046.92	3.09
Promoter	--	127,291.95	127,291.95	11.91
Total	$712,193	$356,418.	$1,068,613.	100.

In the scientific plan proposed in a previous section of this article the value of the tangible assets limits the face value of the preferred stock to $595,079,000, and consequently the common stock would be worth almost eighty dollars per share, the combined value of the total issue of preferred and common stocks being the same in each case. The following table shows the distribution of values under the method described:

Adjusted Distribution--Scientific Method

Company	Face of Preferred	79.57489 per cent common	Total Value Awarded	Per Cent
Carnegie Company	$197,563	$140,391	$337,954	31.63
Federal Steel	81,147	33,699	114,846	10.75
National Tube	67,485	51,056	118,541	11.09
National Steel	33,909	35,562	69,471	6.50
Tin Plate	24,503	23,063	47,566	4.45
Sheet Steel	17,706	2,460	20,166	1.89
Steel Hoop	15,661	16,342	32,003	2.99
Steel and Wire	53,162	48,196	101,358	9.49
American Bridge	35,404	20,765	56,169	5.26
Lake Superior	31,495	24,892	56,387	5.28
Shelby Steel Tube	2,791	151	2,942	.28
Oliver & Pittsburgh, one-sixth.	9,250	--	9,250	.87
Bankers	25,003	17,546	42,549	3.97
Promoter	--	59,411	59,411	5.55
	$595,079	$ 473,534	$1,068,613	100.

In the above tables the values have been given in totals. It may now be worth while to reduce the individual assets and earnings to percentages of the total assets and earnings and compare these percentages with the relative share of securities obtained by each of the companies in the actual allotment of securities as well as in the hypothetical distributions above presented. The relative shares in percentages are as follows:

Share Contributed & Share Allotted

Company	Percentage Contributed by			Percentage Allotted each		
	Tangible Assets	Market Values	Earnings	Morgan	Moore	Scientific
Carnegie Company	33.20	46.10	34.33	41.87	40.49	31.63
Federal Steel	13.64	9.10	10.05	7.99	7.91	10.75
National Tube	11.34	8.10	11.91	7.35	7.07	11.09
National Steel	5.70	5.40	7.51	5.03	4.69	6.50
Tin Plate	4.12	3.70	5.02	4.30	3.15	4.45
Sheet Steel	2.97	2.90	1.44	3.44	2.58	1.89
Steel Hoop	2.63	2.50	3.46	2.20	2.09	2.99
Steel and Wire	8.93	8.50	10.61	6.80	7.41	9.49
American Bridge	5.95	6.10	5.32	4.75	5.29	5.26
Lake Superior	5.29	3.10	5.72	5.58	2.74	5.28
Shelby Steel Tube	.47	.50	.20	.27	.44	.28
Oliver & Pittsburg, one-sixth	1.56	1.30	.23	1.29	1.14	.87
Bankers	4.20	3.60	4.20	9.12	3.09	3.97
Promoters	.00	.00	.00		11.91	5.55
	100.	100.	100.	100.	100.	100.

It is thus evident that under the Morgan plan the securities were distributed to the various interests, neither on the basis of assets, nor of earnings nor on a combination of the two factors. There is indeed a marked similarity between the market value of each company and the assumed value of the securities as above presented. The scientific plan on the other hand would have distributed the securities much more nearly in proportion to the respective earning power of the twelve companies.

IV.

Any investigation of the methods actually employed by the promoters and bankers in effecting the consolidati ns of the period beginning in 1898 and ending abruptly in 1901 ought, it must be admitted, to embrace a study of all of the more important ones and, in addition, all of the various types. Such an investigation is at the present time obviously impossible, because of the fact that the details of these consolidations have thus far been kept secret. Indeed, without the efficient work of the Bureau of Corporations in its study of the steel industry, such a study as that presented in this article could not have been made.

In the case of the other great consolidations, the requisite information, even after an extensive government investigation, is as yet concealed in the records of the corporation involved, or those of the promoters and bankers, or such information has been destroyed.

Since consolidation is likely to continue as a prominent feature of our complex economic organization, it is of the utmost importance that the principles involved as well as the methods employed should be thoroughly understood by the owners of securities in the constituent corporations. In this study attention has been called to both principles and methods, and it has been shown even with the meager and unsatisfactory information available that almost no attempt has been made in the past to establish and apply principles that conform to generally accepted standards of either economics or ethics. Rather the "bargain method" has been in almost universal use.

Under such circumstances, the stronger interests are able to make the better bargain and the weaker interests have the choice of taking what they can get int the exchange of securities or staying out at their peril. Quite generally weaker interests have accepted the terms offered rather than remain independent and subject themselves to the dangers involved in such a course.

So long as the state and national governments pursue their present policy of discouraging or absolutely prohibiting consolidations, such conditions must of necessity continue. When once freedom of consolidation, within prescribed limits, shall be recognized to be one of the conditions necessary for the maintenance of fair competition, the government may well expend in some other way a part of the energy it is now using in prohibiting entirely certain classes of consolidations and in punishing consolidations it has permitted to be formed in the past. It is to be hoped it will take such action as may be found necessary to ensure that the several parties entering into a legitimate consolidation are allotted in the distribution of securities the equivalent of the share which they have severally contributed to its corporation assets and earning power.

Maurice H. Robinson.

Company	Securities and Cash Acquired	United States Steel Stock issued for each $100 old stock		Amount United States Steel Securities Issued in Exchange			
		Preferred	Common	Bonds	Preferred Stock	Common Stock	Total
Carnegie Company:							
Bonds	$159,450,000	...	....	$159,450,000	.....	.....	.....
Stock (all common)	160,000,000	...	....	144,000,000	$98,277,120	$90,279,040	$492,006,160
Federal Steel Company:							
Preferred stock	53,260,200	$110.00	....	.....	58,586,220	.....	.....
Common stock	46,483,700	4.00	$107.50	.....	1,859,348	49,969,978	110,415,546
National Tube Company:							
Preferred stock	39,997,400	125.00	....	.....	49,996,750	.....	.....
Common stock	39,937,400	8.80	125.00	.....	3,514,491	49,921,750	103,432,991
Am. Steel & Wire Company							
Preferred stock	39,998,500	117.50	....	.....	46,998,237	.....	.....
Common stock	49,901.900	...	102.50	.....	.....	51,149,448	98,147,685
National Steel Company							
Preferred Stock	26,992,200	125.00	....	.....	33,740,250	.....	.....
Common stock	31,969,800	...	125.00	.....	.....	39,962,250	73,702,500
American Tin Plate Co.							
Preferred stock	18,325,000	125.00	....	.....	22,906,250	.....	.....
Common stock	27,995,000	20.00	125.00	.....	5,599,000	34,993,750	63,499,000
American Steel Hoop Co.							
Preferred Stock	13,997,500	100.00	....	.....	13,997,500	.....	.....
Common stock	18,995,000	...	100.00	.....	.....	18,995,000	32,992,500
American Sheet Steel Co.							
Preferred stock	24,497,700	100.00	....	.....	24,497,700	.....	.....
Common stock	24,498,800	...	100.00	.....	.....	24,498,800	48,996,500
American Bridge Co.							
Preferred stock	31,348,000	110.00	.....	.....	34,482,800	.....	.....
Common stock	30,946,400	...	105.00	.....	.....	32,493,720	66,976,520
Lake Superior Consolidated Iron Mines Co.							
Common stock	29, 413,905	135.00	135.00	.....	39,708,771	39,708,771	79,417,542
Oliver Iron Mining & Pittsburg S.S.Co., one-sixth interest	421,700	...	.....	.....	9,250,000	9,250,000	18,500,000
Shelby Steel Tube Co.							
Preferred stock	4,776,100	37.50	.....	.....	1,791,038	.....	.....
Common stock	8,018,200	...	25.00	.....	.....	2,004,550	3,795,588

Company	Securities and cash acquired	United States Steel Stock Issued for each $100 old stock			Amount United States Steel Securities Issued in Exchange		
		Preferred	Common	Bonds	Preferred stock	Common stock	Total
Total securities by direct Exchange	881,224,405	.....	.....	303,450,000	445,205,475	443,227,057	1,191,882,532
To syndicate for $174,000 par value stocks, $25,000,000 in cash and services.	174,000) 25,000,000)	.....	.....	.....	64,998,837	64,998,837	129,997,605
To incorporators for cash	3,000	.....	.....	.....	1,500	1,500	3,000
Total, securities and cash	906,401,405	.....	.....	303,450,000	510,205,743	508,227,394	1,321,883,137
Underlying bonds of constituent companies	....	.....	.....	.....	.....	.....	59,091,657
Mortgages and purchase money obligations of constituent companies	....	.....	.....	.....	.....	.....	21,872,023
Grand total securities issued and assumed	906,401,405	.....	.....	303,450,000	510,205,743	508,227,394	1,402,846,817

29 Ed. Lab. 1913

Trans. Ecc 1893

P O

Rev. Acc. Bombay Gov. 1913

Reading #23

INFLUENCE OF THE TRUST IN THE DEVELOPMENT OF UNDERTAKING GENIUS.

By Sidney Sherwood, American Economic Association, Third Series, Vol. I, No. 1, pp. 163-176

In a previous article I attempted to show how organization on a larger scale and of a more complex character was becoming more and more the necessary condition of successful enterprise. The effective anticipation of wants in a more remote future, which is a characteristic of present day civilization, calls for such an arrangement of the productive forces that the process of production shall go steadily forward turning out each year the desired stream of specific goods. But this future demand, while more clearly foreseen than formerly, is yet subject to change and hence the producer's plans must have a considerable amount of elasticity. A large premium is thus placed upon foresight in the anticipation of demand and in preparation to meet that demand.

Again, the area of demand and supply has been widely extended. The market has grown world-wide. This is due in part to cheap and rapid transportation, in part to better knowledge by different nations of each other, in part to the extension of foreign trade, in part to that modern tendency to empire-building which has brought wider areas under a community of law and administration. These facts have placed a high premium on broad and deep intelligence in the entrepreneur. He must know the larger market--what its demands are and what are its sources of supply. He must possess also the ability to take broad views of the plans necessary to bring together this demand and supply. He must be a constructive statesman in industry, capable of forming large and far-reaching policies.

In the third place, the further development of the "division of labor" has increased greatly the technical difficulty of undertaking. The undertaker must be a great engineer in economic matters, understanding how to utilize to the best advantage the highly developed skill of the laborer, the complex adjustment of the machinery and how to combine the two.

Finally, the vast accumulation of modern capital, with the necessity of using large capital in these productive processes, make it essential for the modern entrepreneur to be a great financier. He must know how to get the requisite capital under his control upon advantageous terms, how to manage it economically and successfully, how to meet the payments of interest, how to avoid carrying unnecessary capital, how to preserve the confidence of the investor.

Successful industry thus requires as never before genius in organization. Right organization is the factor in production which is of overshadowing importance. Labor and capital alike have come into a relation of actual dependence on undertaking ability. Mill's famous dictum that "industry is limited by capital" has relatively lost its significance and should be replaced by another, "industry is limited by the organising ability of the undertaker."

In spite of the higher standard of living to-day, there is practically no limit to the creation of capital. The limit to industry

involved in scarcity of labor is likewise relatively remote because modern machinery and modern specialization have rendered labor manyfold more efficient. It is in the scarcity of competent industrial leadership that is to be found the effective limit to the growth of industry. The costly wastes of our modern system are the wastes of misdirected production. The frequency and stubborn vitality of our latter day industrial depressions can be blamed only upon the lack of broad intelligence and sound judgment in the modern undertaker. The little undertaker, in possession of large capital and vast industrial opportunity, is the curse of the present system. He plunges blindly into wrong lines of production, or he pushes his operations beyond the limits which real foresight would have enabled him to see. In his ruin he involves not only his own capitalists and laborers, but other productive organizations as well, and he shocks the confidence of investors generally, so that recovery from depression is excessively slow.

The real function of the trust is to get rid of the weak entrepreneur. It is the natural and spontaneous effort of a progressive industrial organization to get undertaking genius at its head which has produced the trust. The formation of trusts is a process of natural selection of the very highest order.

Where competition is still active, the success of an industry depends on its control by an undertaker great in the qualities I have named; in mercantile foresight, in statesmanlike ability to form the broad policies required by the actual conditions of the world-market, in the technical skill necessary for the nice adjustment of highly specialized machinery and labor, in the financiering of vast capital. A mistake by him in the performance of any one of these four functions may mean, if not immediate disaster, at least inferiority to his rival. Continued success here is in the hands of the greatest leader. But this strenuous competition, this war to the death, while it pushes to the front the leader most capable, at the same time tends to consolidation. The fierceness of the competition, enhancing the wastes of production, compels the competitors to some form of combination and in this combination the control naturally passes to the strongest and most capable of the leaders.

This is the selective process which was characteristic of the change from the individual to the corporate form of industrial organization. The gains which were possible under production on a large scale could be realized only so far as competent leadership of the large operations was developed and in this school of experience the leaders were trained for the still higher work required. It is in the rivalry between combinations that the supreme effect of this process is seen. Having, as the head of a corporation, learned, as it were, to command a brigade, the great entrepreneur develops the fitness to command a division or an army corps.

The strength of the trust is that it gives the opportunity for the exercise of these highest qualities of industrial leadership. The process of forming the trust tends to put the ablest of the great undertakers at its head. For if not, then the really more capable man is not apt to remain quiescent, but breaks away to become a formidable rival again, a rivalry which at last generally results in the supremacy of the stronger. In other words the

persistence of the trust is dependent upon its securing and retaining the highest leadership. Monopoly of a machine will not long secure the trust, for a new machine is likely to be invented; monopoly of franchise will not do it, for such a monopoly may be broken. The monopoly upon which the permanency of trusts must chiefly rest is the monopoly of undertaking ability, a monopoly in its nature temporary and the result of a competitive process.

The test of the leader's ability will be found, in the last analysis, in benefits rendered to the community, i.e., in the securing of the greatest economics in production. Benefits to the community are not synonomous necessarily, as Adam Smith would have us believe, with low prices to consumers. The great body of laborers who want high wages protest against that doctrine, as do the investors of capital. Consumers of any product must be willing to let live as well as to live. Sufficient inducement must be allowed to prudent people to make it worth their while to create new capital, laborers must be induced to acquire skill and sterling character. In other words the successful management of legitimate industry means adequate wages and dividends, no less than lowered prices to consumers. It is the ability to maintain the proper balance between these three forces which will decide the ultimate fate of the trust as a form of industrial organization. The failure to do this inevitably lures new competition. In other words the monopoly is temporary.

A rapid historical survey will show the part which temporary monopoly has played in stimulating competition to progressive effort.

With a people naturally inclined to individual initiative the necessary condition of improvements in production is the prospect of large gain to theinventors of the improvements. With early agriculture, where natural opportunities were large and small capital was required, competition served to bring out the invention of better processes only as such competition was stimulated by the monopoly of private property in the land. This monopoly was a legal one, created by the community to tempt progressive competition. When the gain from this monopoly tended through social growth to become permanent and an obstacle to further progress, a new motive to progress was found in commerce. The active competitive process there soon brought gains overshadowing the gains from land ownership, now grown passive, and Europe changed from a feudal to a commercial economy. But this new competition was made effective only through the monopoly of the merchant guilds and monopolistic trading or colonial concessions. The rising manufactures were likewise built upon the monopolistic aid of the craft-guilds.

The "Industrial Revolution" marks the next radical change and the chief condition of progress became the invention of better machines. The highest competitive activity was secured by patents. The principle of the patent is that a temporary monopoly tempts competition in invention by securing extraordinary gains to the inventor. But these gains are only a small fraction of the gains secured by the community.

The factory, brought about by the new machinery, was due partly to the monopolistic element of the patent law and partly to a certain

tendency to monopoly in the necessity for large capital under single management--a result reached largely by the extension of the corporate form of organization. The old guild system was swept away, having become obstructive to progress, and was replaced by the factory system which broadened and intensified competition, although itself resting on certain elements of monopoly. Superinduced upon this change, before the new movement had worked itself fully out, came the revolution in transportation due to the steam-engine. In stimulating this progress, monopoly again played its role. The patent, the special franchise more or less exclusive, the government subsidy were all made use of to tempt competitors into the field.

These processes--factory production anc oommerce organized upon the new system of transportation--have been working themselves out during our century. Everywhere competition has been made broader and deeper and everywhere this has been accomplished by the luring of enterprise through temporarily monopolistic gains.

Competition can be a benefit to society only when the competitor is so far secure in his possession of the gains resulting from his efforts that he is stimulated to the struggle. So much of egoism is in us still. Where individual control of land, of a trade route, of market rights in a town, of a right of way for a railroad, of ownership in a machine, or of the right to concentrate sufficient capital for efficient production is necessary in order to bring out the full productive energy of individuals, society does well to secure to individuals that measure of such rights which will bring out this energy. Competition which allows the trespasser to oust the land owner, the burglar to rob the merchant, the commercial pirate to infringe on patent rights, or the fraudulent promoter to buy legislative concessions to wreck a well established railroad is destructive competition, is in fact anarchy and obstructive of progress. Monopoly, up to the point where it tends to prevent improvement, is a stimulus to true competition. It tends to destroy wasteful competition and to promote well-planned and responsible competition. During the last half century it has become increasingly true that organization on large lines is the essential of efficient production. This means concentration of large capitals and the highest ability in the management of productive concerns. It is not universally true but it is undeniably true in the majority of enterprises. Following this tendency, more and more the disposable capital of the community and of the world has become concentrated. The movement in banking organization has been in the direction of concentration--either legal consolidation or concentration of actual business operations. If law does not permit of formal legal consolidation, business consolidates itself, as the Clearing House system of this country illustrates. For the right conduct of enterprise, under these conditions, a selective process is needed which will put in control of productive opportunity the men of genius. The trust furnishes such a selective process. The trust is successful so far as it succeeds in getting such men in control. This is not antagonistic to competition, it is a competitive process of the most notable sort. It preserves and stimulates the most active competition at the point in the productive organization where progress can result. It is the most powerful stimulus to call out the best energies of the able industrial leaders under conditions where industrial leadership is the most important factor in production. It is the climax of a long historical

process which has pushed the individualistic peoples to the front in the world's industrial supremacy. The least that we should do in aid of this development is to allow free opportunity for combination --so long as the methods of combination are fair, clean and honorable. So far as the monopoly of machinery is concerned, our patent laws secure temporary monopoly to the combination owning the particular machine and at the same time tempt the competition of better machines. As to the monopoly involved in the necessity for the possession of vast capital by productive combinations, the problem is to safeguard the investor by securing in our banking and investment agencies able management and honest dealing. If this were done, ample competitive capital would be forthcoming as rapidly as needed. If this were done, freedom of combination would be the best safeguard to the investor, for it would aid the ablest industrial leaders to secure control of all the capital they needed to extend their business to the most advantageous limit.

There is another element of monopoly--that inherent in the growing relative limitation of industrial opportunity as society becomes more compact. As population within a given area increases, the line of economic progress is toward relatively fewer distributing agencies, relatively fewer manufacturing concerns, relatively fewer transportation systems. There is here an element of permanent monopoly which requires control by the government in the interest of the community. This control is to be effected either by some system for government supervision, by government regulation of price or by the taxing of a part of the profits into the public treasury.

History has shown over and over again the social gain resulting from temporary monopoly in stimulating competitive improvement by appealing to the speculative instinct of able individuals. The temporary monopoly involved in the trust is the newest instance and it calls out the intensest competition among able entrepreneurs for the mastery of business, a mastery resting upon superior organization. There is, then, no need to restrict the temporary monopolies involved in the trust.

As to the tendency to permanent monopoly discoverable in some lines of business, our experience furnishes us with two types of government regulation which have proved fairly successful and either of which may be applied, with some changes, to combinations--the bureau of the Comptroller of the Currency and the Interstate Commerce Commission. Both in banking and in railroading the growth of business has been steadily toward concentration. The banking laws have prevented consolidation of banks doing business over wide areas. The banks, through the Clearing House and their system of correspondents have actually concentrated the banking business. This federative system of banking consolidation is in accord with our political ideals and is working itself out satisfactorily. The government inspects the business and requires publicity. In spite of all the criticisms urged against the conduct of the Comptroller's office, it must be conceded that on the whole his work has been well done and that the advantages of free and honest competition in banking have been secured to a reasonable degree, without preventing necessary consolidation. A possible method of dealing with the trusts might be modelled upon the National banking system. Combinations local in character could safely be left to local law and regulation.

Combinations which in their operations affected the business of several states or of the whole country might be brought under a general federal law, upon the plan of the National Bank Act. Within the general limits of the law there should be freedom in the formation of local competing corporations and freedom in the formation of federative agreements between these concerns, and even in actual consolidation. A Department of Commerce and Manufactures at Washington, needed also for other reasons, might be created, charged with the duty of regulating the incorporation of these concerns, of inspecting their operations, of requiring reports and publishing the facts. It is believed that such action would meet the requirements of the case with reasonable success. Ultimately it might be advisable to lay special taxes upon the profits if the power of the combinations became oppressive.

The failures of the Interstate Commerce Law have been due to two chief causes. The law did not recognize the fact that consolidation is an inevitable tendency in railroad transportation and has been attempting the impossible in trying to suppress it. Secondly, the Interstate Commerce Commission is a semi-judicial body and has aroused the jealousy of the United States Supreme Court, which has gradually stripped it of the powers which it was intended to exercise. Even so, however, it has accomplished much, largely through the publicity which it has required of the railroads, to secure uniformity, fairness, and honesty in railroad business dealings. If the law, instead of prohibiting pooling, had charged the Commission with the duty of regulating pooling, much more might have been done to secure to the public the benefits of the monopoly inherent in the business. An extension of the scope of the Commission to include supervision of mercantile and industrial concerns doing an interstate business, would, if wisely planned and patiently carried out, furnish a workable solution of the trust problem.

The fundamental superiority of the trust is that it widens the opportunity to effect the economies essential to progress and tends to develop the ability to do this on the part of the managers of enterprises. Much of the hostility to combination is due to a mistaken view of the true economic function of the trust. The managers of the trusts, that inner ring of control, who receive the unreasoning condemnation of the mass of the people, are in reality inventors of superior processes of production, and as such deserve special recognition no less than the patentees of new mechanical inventions. If they cannot secure reasonable returns for the benefits they confer upon the rest of the community they will not be stimulated to work out productive economies. A wise policy would not force them to illegitimate and dishonorable methods of securing their just rewards.

This suggests the most sinister side to this development, the prevalence of oppressive and even fraudulent practices by the trusts and their corruptive influence in our political life. There is good reason, however, based upon historical evidence, for the belief that these evils are not inherent in the nature of the trust but are simply incidental to the changes involved in their formation. All pioneer work has a large element of roughness, violence and disorder. Take a specific instance--the period of great railroad development in this country a generation ago. In that rapid and bewildering

transformation of our transportation system with its immense opportunities for speculative gains, practices were common in the violent and fraudulent conduct of corporate elections, in the debauchery of our legislators and even judiciary, in the defiance of law and public order which have earned an unenviable fame for the unscrupulous ability of our railroad promoters. But enlightened public opinion is far severer to-day in its condemnation of those practices than it was a generation ago, and the management of those roads to-day is relatively conservative, respectable and promotive of the general good.

We need not condone the immoralities of our railroad management. We can recognize, however, even among such a high-toned body of men as our college professors a certain prevalence of methods for securing appointments, promotions and other advantages, which belong rather to political intriguers than to lovers of science. We should recognize further the essential injustice of expecting a higher sense of honor among business rivals than among the members of this profession. But the important fact is that business interests as well as a progressive public conscience have worked toward improvement. This improvement has been marked in the development of our railroad enterprise. We may fairly expect the same improvement in the great industrial combinations as they settle into permanent organizations.

There is a peculiar significance in the fact that while combination is old, trusts are new and are especially the product of the new world. The reason is not far to seek. It is to be found in special conditions existing in America since European settlement here. Throughout our whole history there have existed here scarcity of labor, scarcity of capital and a population ambitious for a high standard of living. Satisfaction of these ambitions was obtainable only through a higher industrial intelligence. Our economic conditions placed a large premium on inventiveness and organizing skill. We have succeeded in applying machinery in production to an extent and with results not equalled elsewhere. Skillful organization has been developed in no less a degree. In fact the use of machinery on a large scale presupposes and requires a higher order of organizing ability. Our industrial leaders developed early in versatility, in acuteness, in the mastery of the practical expedients necessary to success. The qualities of the A merican entrepeneur were the result of a long process of natural evolution. All that was wanted was scope for his energies. This opportunity wasafforded by the industrial revolution and the superiority of the American undertaker first showed itself in the development of the new means of transportation--the railroad system. In boldness and largeness of plan, in rapidity and success of achievement, the American railroad undertaker has led the world. The newest opportunity was that afforded by that extension of the possibilities of commercial and industrial organization which is summed up in the phrase--the world-market. The enlargement of the market makes a higher type of organization a necessity. The trust is the American solution of this problem. Its effectiveness is already becoming recognized abroad--recognized not only by observers but also by imitators. The wider the market, the more economies can be effected by organization, a principle already grasped by Adam Smith. It is upon this historic superiority in the capacity for organization that the future economic

[illegible] exploitation system with its immense opportunities [illegible] gains, practices were common in the violent [illegible] of corporate elections, in the laboratory of [illegible] even judiciary, in the defiance of law and [illegible] order have served as unenviable fame for the uncourtliness of our railroad promoters. But enlightened public [illegible] in [illegible] has been a generation ago, and the management of these roads today is relatively conservative, respectable and productive of the [illegible] good.

[illegible] not condone the immoralities of our railroad promoters, [illegible] however, even among such a high-toned body of men as the college professors a certain prevalence of methods for accumulating [illegible], promotions and other advantages, which belong to political intriguers than to lovers of science. We should [illegible] rather the economical injustice of expecting a higher [illegible]. But the important fact is that business interests in a progressive public conscience have worked toward improvement. This improvement has been marked in the development of our [illegible] enterprises. We may fairly expect the same improvement in [illegible] industrial combinations as they settle into permanent [illegible].

[illegible] is a peculiar significance in the fact that while our [illegible] is old, states are now and are especially the product of our new world. The reason is not far to seek. It is to be found in [illegible] conditions existing in America since European settlement [illegible]. Throughout our whole history there have existed here scarcity of labor, scarcity of capital and a popularized ambitious for a high [illegible] of living. Satisfaction of these aspirations was obtainable [illegible] a higher industrial intelligence. Our economic condi[illegible] caused a large premium on inventiveness and organizing skill. [illegible] results not equalled elsewhere. Skillful organization has developed in no less a degree. In fact the use of machinery [illegible] economy, purposeful and [illegible] a higher [illegible] living ability. Our industrial leaders developed early in versatility, in sagacity, in the mastery of the practical [illegible] necessary to success. The qualities of the American [illegible] are the result of a long process of natural evolution. At last [illegible] was scope for his energies. This opportunity was afforded by the industrial revolution and the superiority of the American [illegible] first showed itself in the development of the new means of transportation--the railroad system. In economy and [illegible], in rapidity and success of achievement, the American railroad has led the world. The newest opportunity was then afforded by the expansion of the resources of commercial and [illegible] combination which is summed up in the phrase--the world's market. The [illegible] of the market makes a higher type of organization necessary. The [illegible] is the modern solution of this [illegible]. The [illegible] is already becoming recognized abroad--[illegible] only by observers [illegible] be origines by organizations. [illegible] Smith. It is upon this historic

supremacy of America must rest. Protection is not the cause of trusts; it is at the most only an incidental aid to their early formation. Their destruction would probably be the death blow to our hopes for industrial leadership in the international struggle for future mastery. They are the most effective agencies yet devised for preventing the wastes of competitive production. What is needed is an enlightened public appreciation of the possibilities for good which they offer and the limitation of their possibilities for evil through calm and wise governmental regulation.

Reading #24

TRUSTS

By Henry C. Adams, Maurice H. Robinson, Henry W. Farnum, American Economic Association. Third Series. Vol. V, No. 2, Pt. 2, 91-137

A trust may be defined as an industry which, on account of its size or of its form of organization, exercises a dominating influence on the production or the sale of the goods in which it deals. This definition renders two important services. It draws a clear line between a great industry and a trust organization of a great industry, and it provides a test for determining what industries have attained the trust organization.

Four lines of argument may be found in current discussion designed to reconcile us with the existence of exclusive industries. The first is that trusts are the result of natural law and are a healthful industrial evolution; the second is that the economic law of competition persists, no matter what the form of industrial organization; the third is that trusts are productive and should receive our approval for the same reason that we grant approval to a labor-saving machine; and the fourth is that common law principles already provide adequate remedy for any conceivable abuse of the liberty of contract. Let us give a moment's consideration to each of these lines of argument.

I. Trusts are the Result of Natural Law

The organization of competing corporations into a single all-embracing business enterprise is regarded by the first class of trust apologists as a normal step in industrial evolution. Upon this point Professor Gunton expressed himself as follows: "One of the marked features of the economic development of the century is the radical change that has taken place in the character of competing units. Under the primitive hand labor method the competing unit was the individual. With the development of factory methods the individual, as a competing unit, was superseded by partnerships, because they could more economically employ the new methods. With the growth of invention, partnerships were superseded by corporations. With the growing completeness of machinery and magnitude of business corporations grew larger and larger, until the corporation is now the prevailing form in the most advanced countries. . . . In short, the progress during the nineteenth century has irrevocable established the group as the competing unit; the union as the unit on the labor side, the corporation as the unit on the capital side." The trust is characterized by Professor Gunton as the successful experiment of many recent experiments in the evolution of the industrial unit.

So far as history is concerned nothing can be said in criticism of the above statement, except that it tells but half a truth. It overlooks the essential point that with every step in the modification of the business unit it has been found necessary to prescribe new legal conditions for the direction and control of industry. Every close student of political economy knows that the doctrine of competition, as foreshadowed by Locke, and Hume, and as expressed by by Adam Smith, was formulated for a society which rested on tools, and that the introduction of the factory system necessitated a modification in the statement of the laws of competition and of the

statutory conditions under which factories were permitted to operate. He is also familiar with the further fact that the appearance of the private corporation about 1840, which by 1870 had become a prevalent type of industrial organization, necessitated a second reorganization of the law of competition, and was the direct occasion of enactments designed to guard the public from threatened evils. The natural conclusion from this appeal to history, when the full story is tole, is not that trusts are a sacred product of natural evolution, superior to statutory control, but rather because they are a new form of industrial organization, that they should be met by a new expression of the law of competition and by a new statement of statutory rights and duties. He is a superficial thinker who sees in this appeal to history a reason why trusts should be permitted an uncontrolled development. In any comprehensive view of society the institution of the state, which rests on coercion, is as natural as the institution of commerce which rests on voluntary association, and as such has an equal right in logic to claim whatevery presumption lies in the theory of evolution or in the doctrine of natural law.

II. Is Trust Competition Effective Competition?

We come now to a consideration of those publicists who assert that competition persists as a controlling force in industry notwithstanding the consolidation of competing companies into a single organization. "Competition," says one of our leading sociologists, "disappears in one form only to reappear in another." This is an eminently sane and just observation and one that no economist would care to deny. It is incumbent upon us, therefore, to inquire what the new form of competition is by which this new manifestation of industrial power is to be controlled, and to ask if it is competent for the task of control.

This class of ideas presents itself under two forms, namely, the claim that competition exists between commodities offered for sale, and the claim (or possibly merely the implication) that we may safely rely upon the substitution of potential competition for active competition.

The logic of that apology for trusts which rests upon the claim that competition of goods will persist notwithstanding the trust organization of industry, may be suggested by the following concrete illustration. If the manufacture of shoes be monopolized, and the monopolist charge too high a price for shoes, while the manufacturer of bonnets, with a keener insight into the psychology of the purchaser, places the price of bonnets on a relatively lower plane, the ladies of the country will choose to go barefoot and spend more in bonnets. This will curtail the sales of the shoe monopolist, and he will, as a result, reduce the price of shoes. Possibly Professor Giddings' statement of the argument may be preferred. He says: "When one group of producers demands unusually high prices, all other groups of producers can very considerably increase their sales in virtue of that law of human nature according to which men can and do, to a great extent, substitute one group of conveniences and pleasures for another, postpone certain enjoyments for the time, and distribute their expenditures at all times in such a way as to obtain the greatest satisfaction for a given outlay."

This expression of the competitive principle is universally conceded, but before one accepts it as a satisfactory apology for trusts, there are two observations to which attention should be called.

In the first place, it should be observed that the full limit of the influence of competition among monopolists for their respective shares of the people's income, is to guard the consumer against flagrant abuse of monopolistic power, and this, I submit, is a poor substitute for that phase of competition by which the public is guaranteed that the price of goods will not exceed their cost. The restraining influence of the fact that if prices are too high sales will be curtailed, is a familiar line of reasoning, but Professor Giddings is the first writer, so far as I am aware, to imply that this phase of competition would grant the same protection as would be granted by free competition between independent producers. The latter phase of competition is a guarantee that the market price will not permanently stand above the cost of the goods; the former is merely a guarantee that the market price of goods produced by monopolists will not be so high as to defeat profitable sale.

My second observation is, should this phase of competition prove to be a real check upon the profits of centralized industries, the same considerations which lead to the consolidation of independent producers in the same line would lead to a consolidation of monopolistic competitors in all lines. But this is so bizarre an idea that I will not claim your time for its discussion.

What now shall we say of the suggestion that, active competition having been suppressed, the public may still place reliance upon potential competition as a guarantee of fair treatment on the part of monopolists, This I understand to be the position held by Professor Clark. By the side of this consideration there should be placed also the suggestion of Professor Jenks that experience on the part of trust managers will induce them to become more and more conservative in the use they make of their monopolistic power. He, too, like Professor Clark, relies upon the claim that the abuse of power invites competition.

I have no desire to deny that potential competition exists, nor that it is capable of exerting a certain degree of influence upon the manner in which a monopoly is administered. That, however, is not the question. The point at issue is whether the public is justified in placing sole reliance upon potential competition, active competition having disappeared with the disappearance of the actively independent producer.

I confess it seems to me that the statement of such a proposition carries with it its own refutation. The establishment of a new commercial enterprise is by no means an easy task. In the first place, considerable time must elapse between the beginning of an investment and the completion of the plant, and the capital invested must either forfeit its earnings during this period, or more capital must be borrowed and charged to cost, with which to pay dividends on outstanding stock. In the second place, the investor must take into consideration the necessary loss incident to mistakes due to experience. A successful manager cannot be found every day and we

may be sure that the best talent is in the service of industries already organized. In the third place, the building of a factory is not the building of a business, the most difficult part of establishing a new industry consists in securing an assured market. And finally, the power of the trust over the avenues of sale are so secure, that free capital and free labor will hesitate a long time before venturing to enter into active competition. All this means a very considerable margin of excessive profit before latent competition can be brought into play.

This class of facts is as well known to the management of the trust as to those who are seeking investment for free capital. Is it not evident, therefore, that the administrators of a trust will calculate upon this barrier against the inroad of competition and adjust prices accordingly? The interests of a trust are not placed in the hands of fools or of cowards, and, in view of the many difficulties incident to the establishment of new industries, are we not justified in saying that potential competition can not go farther than to obviate the most flagrant abuse of power. The American people people have been taught that the fair price is the cost price. For a century they have proceeded upon the assumption that active competition is necessary to guarantee this fair price, and, in view of the manifest inequalities in the strategic position occupied by a monopoly already established, and by a competing concern to be established, it is doubtful is any amount of argument can induce them to rest satisfied with potential competition.

III. Are Trusts Productive?

There is another class of writers who rest their apology for trusts upon the claim that organization is a productive principle and that trusts, which represent the application of this principle to manufactures, are bona fide producers. This means that the consolidation of competing industries is a step in industrial betterment the same in kind, and to be followed by the same advantages, as the substitution of machinery for tools, or the introduction of any method or process by which, for a given amount of labor, a relatively larger amount of wealth may be produced. We can not accept the fact that men have found it advantageous to consolidate competing industries as proff that such consolidations are productive, for such a conclusion overlooks the distinction between produce and profit. It is conceivable that a highly centralized industry may increase profit to the corporation while contributing nothing to the product of the nation; and it may be that a desire to obtain the former rather than to promote the latter lies back of trust organization. It is consequently, pertinent to inquire whether or not the trust is truly productive.

There is nothing mysterious about the process of production. It consists in the application of labor to the making of useful goods or the rendering of useful service. It includes agriculture, the object of which is to secure possession of raw material; it includes manufacture, which consists in fashioning material to meet the needs of consumption; it includes commerce, which consists in the transportation of material and product to the consumer. Modern refinements of economic theory respecting value have not seriously modified this fundamental structural description of what constitutes

industry. If, now, it be true that the amalgamation of independent competitors constitutes a productive process, that productivity must show itself in one of the three lines of activity described. Under no other assumption is it reasonable to say that the trust organization is productive in the sense that the invention of a labor saving machine is productive.

So far as that phase of commerce which has to do with transportation is concerned, it is admitted that the size of plant and density of traffic are a rough measure of productive ability. Can the same be said of the process of manufacture? Is it like railways, subject to the law of increasing returns? Consider what is implied in such a concession. If this be true there is no assignable limit to the profitable size of a manufacturing plant. If this be true, the principle of monopoly inheres in the manufacturing industry. If this be true there is the same reason why government should interfere in the manufacturing industry as there is why government should undertake the control of railways. While admitting that these considerations open up a field of economic theory as yet but partially explored, I confess I am unable to grant such conclusions. To me, it seems clear that the process of manufacture is subject to the law of constant returns and that, on this account, the thought of monopoly is foreign to its nature. Both analysis and experience make evident the fact that beyond a certain point, increase in the size of a manufacturing plant does not contribute to economy. The growth of the typical industry during the past century and a half should cast no doubt upon this conclusion, for this growth, so far as it inheres in the nature of the manufacturing processes, is primarily the result of new inventions and of new applications of the principle of division of labor. If, now, the only normal motive for increasing the size of manufacturing industries be to make room for a new invention, it is evident that, at any particular time in the development of commercial arts, there is for every branch of manufacture a size which enables the full realization of the principle of division of labor. This may be termed the size of maximum productivity, and provided a manufacturer has sufficient capital to enable him to own a plant of this maximum size, he can easily hold his own in the world of competition. Indeed, an increase in size beyond this point, unless it be a complete duplication of the plant, will result in a decrease of efficiency, for it introduces confusion into what before was a perfected application of the principle of division of labor.

The converse of this is also true. If a manufacturer fails to increase his capital to the size required for the most effective use of machinery, he will be forced to the wall, a fact which suggests the observation that, not only are trusts in themselves unproductive, but they will, if they gain control of the industrial field, tend to check development in the technique of industry. It does not lie within the purely commercial motive to force a monopolist to adopt the latest and most effective mechanical devices. On the contrary, the monopolist waits upon the wear of old machinery before adopting improved methods. If you ask what is the fundamental explanation of the tendency towards the consolidation of manufacturing plants, I reply, it is the desire on the part of the proprietors of inferior plants to shield their capital from the competition of more perfect methods of production. The man with a poor plant sets the ball rolling by offering goods at cut-throat prices, for he has little to

lose and much, possible, to gain; the man with the best plant, seeing the advantage due him from his enterprise threatened by this predatory competition, tries first to club his free booter rival into submission, and if he fails in this, takes him into partnership. This is the way in which trusts grow. The initial motive is to secure an income from poor capital. The final result of organizing industry in response to this motive will be to check enterprise. Just at present, while the process of consolidation is going on, and while the vision of a world's market is before the American manufacturer, it may be that trusts tend to render general the best methods of production; but the end is not yet. Monopoly is now what it always has been. The only means of perpetuating itself is by stifling energy and limiting progress. In response then, to the inquiry respecting the productivity of trusts, there seems but one answer. Confining the question to the process of manufacturing, not only does the amalgamation of independent producers into a single industrial organization contribute nothing to the cheapness of the process of manufacture, but allowed its normal development it will, to speak mildly, tend to dampen the ardor for improvement, and thus bring us to the beginning of the end of the "industrial revolution."

It may be urged that I overlook the savings incident to great organizations. No, I do not overlook the possibility of savings. Savings incident to great industries are of two kinds; first, the production of by-products in sufficient quantities to make their collection and preparation for the market profitable, and second, the avoidance of unnecessary expense in the administration of the business and in the sale of the product.

So far as by-products are concerned, provision has already been made for them in the statement that the normal size of a productive industry tends to increase with every improved appliance or perfected process. The discovery of a new by-product may necessitate an increase in the size of the plant, but the increase thus necessitated is limited to the size required for collecting these products in profitable amounts. In order, therefore, to introduce the saving of by-products into an argument for the support of an organization of the country's industries in which each product is represented by a single producer, it would be necessary to show that nothing less than 75,000,000 of consumers would furnish a market sufficiently extended to warrant an industry of the size required by maximum efficiency. Such an assumption is absurd, and doubly absurd when to the home market of 75,000,000 of consumers we add the world's market. Large industries may be necessary to enable the savings of by-products, but not a trust of large industries.

With regard to savings in administration through consolidation, I confess I am somewhat skeptical. It is true that the number of presidents may be decreased, but what shall we say of the salaries of those that remain? It is true that expenditure for advertising may be reduced and the payroll of travelling salesmen curtailed; but we are entirely in the dark as to the extent of this saving. In the absence of information we are obliged to go back to analysis and to rely on fundamental principles. If the manufacturing industry can be organized like an army, if the decision of the management in one case may be generalized into a universal order, if, in short, the process of making and selling goods is a process <u>en gross</u>, like

transportation, and not a process that commands at every step the personal attention of trained intelligence, then we might talk of savings in administration incident to consolidation. But such is not the character of the manufacturing industry. The nature of the manufacturing process does not permit of such savings at least to the extent that it becomes a controlling consideration in the organization of the business. Moreover, these arguments do not fit well together. Laborers, we are told, are to get more for their work, investors are to get more on their capital, and, so far as we can learn, the salary list of officers is not greatly decreased. Where, then, in view of the fact that the inevitable tendency of monopoly is to stifle invention, is there any saving that the public is able to see. There remains only advertising and travelling men, a mere bagetelle, if exception be made for patent medicines, as compared with the average of expenditures incident to great enterprises; and I submit that the abandonment of active competition which is the only guarantee the public has for continued development in the technique of industry and for fair treatment upon the market, is a high price to pay for the destruction of ten cent magazines and the suppression of the travelling fraternity.

If trusts are not productive, are they profitable? Yes, trusts are profitable. They are profitable to their promotors and to those who by means of them are able to convert the common stock of a sinking concern into the preferred stock of a consolidation, provided the consolidation enjoys a monopoly of the market. The promotor makes money by over capitalization. For him the organization of a trust is merely a new phase of the old stunt of crystallizing a temporary advantage into a vested interest and then selling it out to innocent holders. But I cannot follow farther this line of analysis.

Possible Solutions

This paper would be incomplete as an introduction to general discussion should it contain no reference to the solution of the trust problem. As indicating the general point of view, it may be remarked that it is a mistake in strategy, if not, indeed, in logic, to treat the trust as though it were an industrial institution like the corporation or the trades-union. The trust is rather a phase of corporate activity called into prominence by a combination of causes. It is, therefore, possible to destroy what we call the trust without impairing the efficiency of capital or the productivity of labor. A satisfactory programme of reform must touch the underlying causes of this present phase of industrial consolidation. I cannot, of course, speak of all these causes, but venture to mention three, each of which should have a place in any programme for the correction of prevalent abuses.

First. A survey of the past hundred years of industrial change makes evident the fact that industry on its mechanical side has developed more rapidly than on the side of management and administration, and in any final explanation of congested competition, a phase which appears to me to suggest a fairly accurate diagnosis of the industrial ills of our time, the scarcity of business talent holds an important place. I do not regard this as a fundamental explanation of trusts, but as a contributary condition of deep significance. In so far as the centralization of industrial power is traceable to

failure in the supply of business ability, no permanent relief from the evils of trusts may be expected until the highest grade of business intelligence becomes the common possession of the business world. The trust may be regarded as a corner in business insight, business talent and business courage. Many agencies must cooperate to break this corner, but among these agencies none should be assigned a more important role than the universities and colleges of our land. When high grade commercial education comes to be acknowledged as a legitimate as a legitimate and dignified phase of university instruction, and made attractive for young men ambitious for business success, the first step will have been taken toward the restoration of those conditions in which healthful competition can again control industry. From the point of view of our universities the solution of the trust problem means the development of courses in higher commercial education.

Second. A study of the market since the introduction of steam transportation makes clear the fact that the temporary collapse of the competitive principle pertains to the transportation and sale rather than to the manufacture of goods. How far the recognition of this fact might lead the government in the regulation of the market, no one can say; but one point is clear. That which gives character to the modern market is the rule according to which payment is made for the service of transportation. This means that the railway problem lies at the bottom of the trust problem. In making this statement, however, I am unwilling to concede that the solution of the railway problem is limited to the guarantee of equal facilities to all shippers at the same price. The heart of the problem lies deeper. If the mischievous features of tursts are to be dissipated through the agency of railway reform, that reform cannot be arrested until the principles of public utility, rather than cost of service, becomes the ruling consideration in the formation of freight and passenger schedules. Before an audience of economists it is not necessary to develop such a suggestion, but I may, perhaps, indicate the extent to which my mind has been forced along this line of reasoning by the remark, that the railway problem will not have been solved until the manufacture and the sale of goods is again brought under the control of normal and healthful competition. Should this require the nationalization of railway property I find myself constrained to admit that the dangers incident to such a policy are of relatively less significance than t he dangers with which our industrial organization is threatened by the perpetuation and further development of manufacturing and commercial monopolies.

From the point of view of government then, the solution of the trust problem demands before all else, an efficient governmental control of the business of transportation, to the end that all manufacturers may be treated alike in the markets of the nation. The trust is that the monopolistic features of trusts pertain to the buying of material and to the selling of goods. It is market conditions and not manufacturing conditions that should claim the attention of the reformer.

Third. Neither the paucity of business talent nor the mal-adjustment of railway schedules is adequate to fully explain the tendency toward monopoly among manufacturers. Mention must be made

of a third cause equally potent and infinitely more difficult of adjustment. I refer to labor organizations. The question as to whether trades-unions can or cannot raise wages is a familiar one to economists, but one feature involved in this controversy seems to have been overlooked. He who follows the logical development of the concession made by John Stuart Mill,--namely: that organization among workmen can increase the price of the commodity which they sell,--will be brought, sooner or later, to the conviction that every step in the rise of wages, traceable to the demand of workmen for higher pay, results in the disappearance of those employers who, under the old rate of pay were just able to maintain a profitable existence. Expressed in a sentence, this means that every successful strike sets in motion those forces which result in the concentration of industry. Trades-unions may raise wages, but they do so at the expense of the small employer. If this be true, it is evident that the solution of the trust problem, or perhaps it would be better to say the readjustment of industrial forces and conditions by which the principle of commercial competition will be placed again in the seat of control, can not be attained without a final determination of the relative rights and duties of employers and employes, and the evolution of an organization, partly political, partly industrial, by which these rights and duties may be expressed, and through which they may be realized.

From the point of view of the economist therefore the solution of the trust problem means a more perfect analysis of industrial conditions and a more perfect understanding of the moral rights and obligations of labor. Of one fact we may rest assured. If the industrial analysis be clear, and the moral rights be plain, those who make our laws and administer our courts will not be backward in giving to these rights an efficient expression.

Reading # : 25

United States Shipbuilding Company
Incorporation

The United States Shipbuilding Company was incorporated on June 17, 1902, under the laws of the state of New Jersey. The incorporators were Howard K. Wood, Horace S. Gould, and Kenneth K. McLaren. . . The incorporators collectively subscribed for fifteen shares of the preferred and fifteen shares of the common stock of the company.

On June 24, 1902, the incorporators above named, constituting the stockholders of the company, held their first meeting. . .At this meeting Frederic K. Seward was elected a director for one year, Raymond Newman was elected a director for two years, and Louis B. Dailey was elected a director for three years, the minutes of the company reciting that Howard K. Wood, one of the incorporators and subscribers to the stock, had assigned his right to one share of common stock to each of the persons above named to qualify them as directors. No stock of the United States Shipbuilding Company, however, was issued to or placed in the name of these directors, so far as the records of the company disclose.

On the said 24th day of June, 1902, the first meeting of the directors of the United States Shipbuilding Company was held. At this meeting there were present Louis B. Dailey, Raymond Newman, and Frederic K. Seward, being all of the directors. The minutes recite that the Board proceeded to the election of officers for the ensuing year, and, ballots having been cast and counted, it was found that Raymond Newman had been elected president; Louis B. Dailey, vice-president; and Frederic K. Seward, secretary and treasurer. The persons above named as incorporators were. . . all connected with the Corporation Trust Company of New Jersey as officers or otherwise, and the place of residence above stated being the New Jersey office of said Trust Company. The directors were also employees of said company.

At this meeting of the directors an offer was received from one John W. Young, of which the following is a copy:

OFFER OF PROMOTERS

New York, June 24, 1902

To the Board of Directors, etc.,

I hereby offer to convey, sell, etc., . . . unto your Company for the consideration hereinafter stated, the following property, viz.:

(1) All of the capital stock of the Union Iron Works of San Francisco, Cal., . . . together with all of its property, real and personal, business and good will as a going concern, I hereby agreeing that this corporation has no bonds out and no indebtedness except current accounts, etc.

Messrs. Henry T. Scott and Irving M. Scott have agreed with me. . . to enter into the usual contract with your Company not to compete with it in its business, and not to employ their capital . . .for the period of ten years.

This offer of the stock and property of the Union Iron Works is made also upon the following express conditions, viz.: That your Company shall enter into a contract extending over a period

of five years with Messrs. . ., now connected with the management of the Union Iron Works, to act as officers or managers. . . for this period of five years at an annual salary to be paid to each of $10,000, etc.

(2) The entire capital stock of the Harlan & Hollingsworth Company of Wilmington, Del., etc.

(3) Also the entire capital stock of the Eastern Shipbuilding Company, etc.

(4) All of the real estate of the Canda Manufacturing Company, etc.

(5) Also the entire capital stock of the Crescent Shipyard Company. . . and the business of the Crescent shipyards heretofore conducted by Lewis Nixon.

* *

(6) Also the entire capital stock of the Samuel L. Moore & Sons' Company. . .

(7) Also the entire capital stock of the Bath Iron Works . . . and of the Hyde Windlass Company. . .

(8) Also 300,000 shares out of an entire issue of 300,000 shares of the capital stock of the Bethlehem Steel Company. . . engaged in the business of manufacturing and dealing in iron and steel and the products thereof.

I will also pay, or cause to be paid, to your Company $1,500,000 for working capital, and will also deliver, or cause to be paid and delivered to your Treasurer or other nominee, the following securities, viz.: $1,500,000 in par value 5 per cent, thirty-year gold bonds of Un ted States Shipbuilding Company, the same to be held as Treasury assets and disposed of for working capital or other purposes of the Company as your Board of Directors shall hereafter determine.

It is a further condition of this offer that in cases where your Company shall acquire both capital stock and properties of any of the corporations included in this offer, you shall guarantee, or otherwise assume, any promissory notes or other obligations which it may be necessary or desirable to put into the treasuries of such corporation or corporations for the protection of their creditors, or to avoid violation of the statutes of any state or states.

I will accept in full consideration for the conveyances. . . above offered to be made $19,998,500 in par value of the full paid and nonassessable preferred stock of your Company, $24,998,500 in par value of the full paid and non-assessable common stock of your Company, $16,000,000 par value of the first mortgage five per cent sinking fund thirty-year gold bonds, Series A , of your Company secured by a mortgage which will be a first lien upon all the property and plants of the Union Iron Works, etc. (above named companies); also $10,000,000 par value of the 5 per cent twenty-year gold bonds to be made by your Company and to be secured by a mortgage upon the shares of stock of the Bethlehem Steel Company and otherwise, as hereinafter stated.

In case you accept the offer of the stock of the Bethlehem Steel Company the purchase must be made upon the following conditions:

(1) The stock. . . is to be deposited with the New York Security & Trust Company under a mortgage or deed of trust which

shall be a first lien upon the stock so acquired, and, subject to the priority of the mortgage to secure said $16,000,000 of bonds, shall be a lien upon the property and plants covered by said $16,-000,000 mortgage. . . The holders of each $1,000 par value of said bonds to have the same voting power as the holders of each $1,000 par value of the stock of your Company.

(2) For the purpose of further securing said issue of $10,000,-000 of bonds, your Company shall also procure to be executed and delivered to the New York Security & Trust Company, the single bond of the Bethlehem Steel Company payable to said Trust Company for the sum of $10,000,000 gold coin, with interest thereon at the rate of five per centum. . . ., conditioned for the due payment of the principal and interest of said issue of $10,000,000 of bonds, etc.

(3) That an agreement shall be executed between the Bethlehem Steel Company and your Company, by which said agreement your company shall undertake to guarantee so long as any of said issue of $10,000,000 bonds are outstanding, that the Bethlehem Steel Company shall pay dividends upon its capital stock at the rate of Three Dollars per share per year, aggregating an annual dividend contribution of $900,000, and for that purpose that your Company will supply and furnish said Bethlehem Steel Company. . . business and . . . means of earning to enable it to pay said annual dividends . . . or advance sufficient money. . . to make such annual dividend payments which may be credited on any business or work which said Bethlehem Bethlehem Steel Company may thereafter have for or on account of your Company. Said agreement shall further provide that so long as any of said issue of $10,000,000 bonds remain outstanding, said Bethlehem Steel Company shall be protected in keeping on hand and maintaining cash or cash assets of not less than $4,000,-000 cash value over and above its current business liabilities (not including its present and projected issue of bonds) as its working capital, no part of which shall at any time be used or applied towards the payments of dividends or for purposes other than the operation and conduct of the business of said Bethlehem Steel Company.

(4) That so long as any of said $10,000,000 bonds are outstanding said Bethlehem Steel Company shall always remain an independent and distinct corporation, and shall not be merged in or consolidated. . . unless. . . requested or consented to by the holders of not less than 75 per cent of said outstanding bonds.

(5) That your Company may at any time pay all of said outstanding bonds as an entirety by depositing a sum equal to the par value . . .with interest. . . to the New York Security & Trust Company as trustee.

I will cause to be delivered to your Company suitable deeds, bills of sale and transfers, etc.

* * * * * *

(Signed) John W. Young

Upon the receipt of this offer the directors above named, holding no stock whatever in the Company, but at most a mere subscriptive right, by assignment, to one share each, adopted the following resolution:

ACCEPTANCE BY COMPANY

Whereas, John W. Young has offered to convey, sell, etc., . . .; and,

Whereas, In the judgment of this Board the value of the properties so offered. . . is at least the par value of the stocks and bonds of this Company proposed to be issued therefor, to wit, the sum of $70,997,000, and said properties are necessary for the business of this Company;

Resolved, That said offer be and the same is hereby accepted, etc., . . .

Further resolved, That for the purpose of enabling this Company to accept the foregoing offer, it shall as soon as practicable take the steps required by law for the increase of its authorized capital stock from thirty shares of $100 each. . . to four hundred and fifty thousand shares of $100 each, two hundred thousand shares of which shall be preferred stock, and two hundred and fifty thousand shares of which shall be common stock, making a total authorized capital stock of $45,000,000. . .

Further resolved, That the officers of this Company be, and they hereby are authorized and directed to make. . . to the Mercantile Trust Company as Trustee, a mortgage or deed of trust upon the properties purchased pursuant to the offer of said John W. Young (exclusive of the shares of stock of the Bethlehem Steel Company), to secure the payment of $16,000,000 par value of first mortgage 5 per cent thirty-year sinking fund gold bonds, etc., . . .

Further resolved, That the proper officers of this Company be and they hereby are authorized and directed to make. . . a mortgage or deed of trust to the New York Security & Trust Company as Trustee, of the shares of the capital stock of the Bethlehem Steel Company. . . to secure the payment of $10,000,000 par value of the 5 per cent twenty-year gold bonds of this Company, which mortgage shall contain the provisions required under the terms of said offer, etc, . . .

Further resolved, That the officers of this Company are hereby authorized to execute, issue, and deliver to the said Young . . .the first mortgage. . . gold bonds of this Company of the aggregate par value of $16,000,000,. . . $10,000,000 and certificates for 199, 985 shares of the preferred capital stock. . . and for 249,985 shares of the common capital stock, etc.

INCREASE OF CAPITAL STOCK

On the same day, to wit, the twenty-fourth day of June, . . . a meeting of the stockholders of said Company was held for the purpose of authorizing and increasing the capital stock of the United States Shipbuilding Company and of considering and acting upon the offer of said John W. Young. There were present Frederic K. Seward, Louis B. Dailey, Kenneth K. McLaren, Horace S. Gould, Howard K. Wood, and Raymond Newman, claiming to be holders of fifteen shares of preferred and fifteen shares of common stock of the United States Shipbuilding Company, being all the capital stock of said Company. At this meeting the following resolution was adopted:

Resolved, That the action of the Board of Directors. . . be . . .approved, ratified, and confirmed, etc.

At a meeting of the Board of Directors of the United States Shipbuilding Company held on July 31, 1902, the following resolution was adopted:

The Board of Directors, etc., do hereby resolve and declare that it is advisable that the capital stock of this Company be changed from thirty shares. . . to four hundred and fifty thousand shares. . . of capital stock, etc.

* * * * * * * * *

PURCHASE OF SUBSIDIARY PLANTS

Between the fifth day of August, 1902, and the twelfth day of August, 1902, in evident compliance with the offer of said John W. Young and the acceptance thereof. . . the companies . . . conveyed to the United States Shipbuilding Company all their real and personal property. . .

* * * * * * * * *

LEASES TO SUBSIDIARY COMPANIES

Your receiver further reports that after the delivery of said deeds. . . leases were entered into between the United States Shipbuilding Company and the (various companies hereinbefore named). . . By the terms of these leases "all the yards, docks, and plant," etc., were leased to the above named constituent companies "at the yearly rent or sum of the net profits of the said party of the second part in its business during the term of this lease." . . . In the Union Iron Works lease the entire plant and property were leased for one year to the Union Iron Works for the nominal rental of one dollar. All such leases were terminable on five days' notice.

ALLEGED BASIS OF DIRECTORS' ACTIONS

The resolution of the Board of Directors of the United States Shipbuilding Company accepting the offer of John W. Young, above set forth, was stated by said Board in its minutes to be based upon a report in writing from Messrs. W. T. Simpson, Fellow Institute Accounts, New York, and Riddell and Common, Chartered Accountants, on the condition of the business of the several companies mentioned in said offer, excepting the Bethlehem Steel Company. This report is alleged to have certified, among other things, that the contracts of the constituent companies for construction then in hand amounted to over thirty-six millions of dollars. That the time necessary to complete the work contracted for averaged about eighteen months from January first, nineteen hundred and two, and that the estimated net profits thereon had been calculated at over five millions of dollars. That new work was being constantly offered, and this new work, replacing completed contracts from time to time, should result in the realization of an average annual profit on work in hand and in sight of two million two hundred and twenty-five thousand dollars.

With reference to the Bethlehem Steel Company, the minutes of the Board of Directors recite that Messrs. Jones, Caesar & Company, chartered accountants, had been investigating the affairs of the Bethlehem Steel Company, and had made a report that the company was earning at the rate of one million eight hundred thousand

dollars per year; that it had a working capital of over four millions of dollars, and that it had contracts in hand sufficient for its full running capacity for three years. In reliance upon these alleged reports, and without knowledge of, or investigation into, the merits of the properties, the resolution in question was adopted.

'TS OF THE DIRECTORS

A comparison of the figures alleged to have been relied upon by the Board of Directors in accepting the offer of John W. Young, with the true figures ascertained from an examination of the subsidiary companies subsequent to the purchase of said plants, discloses so great a variance as to impel the belief that the figures contained in the minutes were wilfully misstated. It is extremely doubtful whether any report was submitted by any accountants made as of that time, as the minutes recite. In a certain Prospectus marked "Private and Confidential" bearing date the 19th day of April, 1902, there is contained a letter purporting to be signed by Messrs. Simpson and Riddell and Common, under date of January 24th, 1902, which letter would seem to serve as a basis to a certain extent for the allegation in the minutes of the Board of Directors. If the examination of these accountants was made as of January 1st, 1902, as the letter would imply, it must have been of the most superficial kind. The letter in question makes such exaggerated representations with reference to the profits, present and prospective, as to make it absolutely worthless as a guide in ascertaining the real condition of the plants. It is entirely refuted by their later reports and detailed statements made as of June 30th and July 31st, 1902.

Your Receiver has seen and inspected the statements made by these accountants as of June thirtieth, nineteen hundred and two, and July thirty-first, nineteen hundred and two, and finds nothing therein to support the statements contained in the minutes of the Board of Directors.

The statement of Messrs. Simpson and Riddell and Common of the condition of the subsidiary plants as of June thirtieth, nineteen hundred and two, contains, among other things, the following figures:

1. Contract price	$34,377,408.70
2. Value of work done under said contracts up to June 30 1902	13,771,768.96
3. Value of work to be done under said contracts subsequent to June 30, 1902	20,605,639.74

The report of these accountants also contained a statement of the volume of business done by the constituent companies for the three years ending June thirtieth, nineteen hundred and two, on which the profit was shown to be about ten per cent. The report also shows that the contracts remaining unfinished on June thirtieth, nineteen hundred and two, would require three years for their completion.

From this report the following facts clearly appear:

1. That the amount of contracts on hand June thirtieth, nineteen hundred and two, instead of being Thirty-six Millions of Dollars, as recited in the minutes of the Board of Directors, was $15,394,360.26 less than the amount therein stated.

6

Trans I

1. Explain the principal of natural advantage.
2. Theory of Equalization
3. Objections to present method of distribution.

I The principal of natural advantage includes such items as.

1. Nearness to market
2. Other competition.
3. Cost of labor.

This principal is used in transportation because some industries have the advantage of several means by which to put their goods on the market such as several railroads, water route etc. Also they may be located in a district where labor is cheap. They may be close to raw materials or market. All these items must be considered in the principal of natural advantage

1

2 In the theory of equalization the purpose is to ~~to~~ put all the shippers on an equal rate base. That is if two industries are located in the same place one should not be benefitted by a lower freight rate. If one shipper has an option of shipping on two roads one of which is a circuitous route the theory of equalization is brought in thro the fact that both the roads will have practically the same thro rate altho

2

3

one of the roads is longer than the other. The principal is equal rates to shippers in same territory on goods going to same place.

Schandt E M
Evans I

2. That it would take three years to earn whatever profit was involved in these contracts, instead of eighteen months, as alleged in the minutes.

3. That the profits on such contracts, instead of amounting to $5,000,000, as the minutes recite, basing the estimate upon the past earnings contained in the report, would be about two millions of dollars; and,

4. That the statement that the average annual profit on work in hand and in sight of the constituent companies, exclusive of the Bethlehem Steel Company, was $2,225,000, appears to have no more substantial basis than the wildest conjecture.

AMOUNT OF CONTRACTS, JULY 31, 1902

Your Receiver has caused to be prepared a statement showing the contracts in force on the 31st day of July, 1902, the portion thereof completed, the balance remaining uncompleted, and the estimated profit thereon, based upon the highest possible estimate of earnings, which is annexed hereto marked "Schedule No. 2," and made a part thereof. From this statement it appears that the face value of the contracts on hand, including extras, on July 31, 1902, was. $34,097,739.23
The value of work done on said contracts up to July 31, 1902, was. 14,295,195.15
Leaving the value of the uncompleted work on said contracts on July 31, 1902. . . . . .$19,802,544.08

ESTIMATED EARNINGS ON SUCH CONTRACTS

Adopting the figures of the accountants and estimating profit on the basis of percentage of completion reported by them and the actual cost of such percentage, the highest possible estimate of earnings on the balance of the contracts to be completed would be $2,203,269.83, as appears from said "Schedule No. 2."

An examination of the books of the Company, however, with care and the exercise of some intelligence, and adjusting the amount of the contracts at corrected figures, would have shown that there was no basis for the foregoing figures, but that there might be justification for an estimated profit of $1,660,021.59, as appears from the statement hereto annexed, made a part hereof and marked "Schedule No. 3."

An examination as of August 1, 1903, however, with the past year's work as a basis, and allowing for changes in extras, discloses another set of figures and shows that the profit on such uncompleted contracts cannot exceed the sum of $1,078,261.42, as appears from the statement hereto annexed, made a part hereof and marked "Schedule No. 4."

From this latter Schedule, which is based upon the actual cost of the work, so far as ascertainable, a situation is disclosed so much at variance with the figures alleged to have been relied upon by the Board of Directors as to lead to the belief that the minutes of the Board of Directors in this respect must have been wilfully falsified. The Five Millions of profits dwindle to about One Million; the contracts therein referred to will not be completed for upwards of three years, and, judging frompast experiences, it

is safe to say that this estimated profit will suffer great depreciation before the completion of the contracts.

WORKING CAPACITY OF PLANTS IN RELATION TO EARNINGS

So far as your Receiver is able to ascertain, the full capacity of the yards, exclusive of the Bethlehem Steel Company, is about fourteen million dollars of work annually, while twelve million dollars is an average volume of work. From the figures contained in the report of the Messrs. Simpson and Riddell and Common, it appears that the average profit of the yards for the three years preceding their purchase by the United States Shipbuilding Company did not exceed ten per cent. Upon this basis the average annual profit derived from the yards, on the basis of the capacity above stated, would not exceed a million four hundred thousand dollars.

EARNINGS FOR THE YEAR ENDING AUGUST 1, 1903

This basis, however, is no guide to the actual earnings of the constituent companies. After being in operation for one year under the control of the United States Shipbuilding Company, the earnings of the constituent companies, exclusive of the Bethlehem Steel Company, instead of being $2,225,000, as alleged by the Directors, or $1,400,000, as figured on the above basis of ten per cent, did not exceed $833,458.74, as appears from "Schedule 5," hereto annexed and made a part hereof.

It has beensuggested that the poor showing in regard to earnings is due to the increased cost of labor and material during the past year. It is true that the cost of labor was greater during the past year than the previous years, and that there were some losses occasioned by strikes; but it is also true that, by reason of the combination of all the yards under one management and the attempted control thereof by the United States Shipbuilding Company, there should have been a great reduction in the management expenses. This reduction in expense, however, did not come to pass, and one reason for it may be found upon an examination of the offer of Young, above set forth. In this offer it will be found that in the case of the Union Iron Works, Eastern Shipbuilding Company, Samuel L. Moore & Sons' Company, Bath Iron Works, and the Hyde Windlass Company, it was provided that the United States Shipbuilding Company should enter into contracts with certain persons therein named for upwards of five years at salaries, in many instances, greater than the earnings of the subsidiary company would warrant. The acceptance of this offer, therefore, with these conditions imposed, not only reduced the earnings of the subsidiary companies, but left the officers in charge thereof practically free from interference by the Board of Directors of the United States Shipbuilding Company for a period of five years, a fact that must necessarily have had considerable influence upon the management and earnings of the individual plants. This fact, however, does not wholly explain the failure of the earnings of the constituent companies to reach the amount of earnings estimated in the preliminary reports. The real reason why the earnings fell below the anticipated profits was because previous alleged earnings had been figured upon a percentage of completion of contracts, which percentage in many instances was erroneous. For instance, in the case of the torpedo boats "Nicholson" and "O'Brien," it was stated that these boats were fully completed. As a matter of fact there was subsequently expended thereon the sum of $56,271.04, and it is estimated that upwards of $20,000 is still needed to com-

plete these boats. Your Receiver, therefore, respectfully submits that the method of arriving at profits earned previous to the combination was practically worthless for the purpose of ascertaining accurate results, and led to the inaccuracies in the estimates for the future.

BETHLEHEM STEEL COMPANY

In regard to the Bethlehem Steel Company, the minutes of the Board of Directors with reference to the offer of the said Young, recite that an investigation of the affairs of that company discloses that it was earning at the rate of $1,800,000 a year, and that it had a working capital of over $4,000,000. For the two years preceding the adoption of the resolution in question by the directors the earnings of the Bethlehem Steel Company for the fiscal year ending the thirtieth day of April were as follows:

1900-1901	$381,403.83
1901-1902	978,743.81

From these figures, as to the earnings of the Bethlehem Steel Company, which are made up from the report submitted by the Bethlehem Steel Company, it appears that the earnings of that company at the time of the adoption of the resolution were much below the amount alleged in the minutes of the Board of Directors of the United States Shipbuilding Company, and that there was then no justification for the use of such figures.

It also appears that the working capital of the Bethlehem Steel Company at the close of their fiscal year on the thirtieth day of April, nineteen hundred and two, was not over $4,000,000, but was at least $250,000 less than such amount, as hereinafter set forth.

WORKING CAPITAL

From the report of Messrs. Simpson and Riddell and Common, as of July 31st, 1902, not made, however, until after the properties had been acquired and paid for, it appears that the working capital of the constituent companies, exclusive of the Bethlehem Steel Company, was $3,278,798.48. The figures making up this total were subsequently found to be excessive in the case of nearly every company, the shrinkage amounting to $1,450,367.41, so that the working capital of the constituent companies was but $1,828,431.07, as appears from the statement hereto annexed, marked "Schedule No.6" and made a part hereof. From the statement hereto annexed, marked "Schedule No. 7," and made a part hereof, it appears that with the exception of the Union Iron Works, the subsidiary companies, taken together, had absolutely no working capital; but on the contrary their liabilities exceeded their resources in the sum of $294,719.33. By reference to this schedule it appears that the following was the condition of said companies at the time of their purchase:

DEFICIT

Bath Iron Works	$3,518.74	
Crescent Shipyard Company	403,192.28	
Harlan & Hollingsworth Co.	73,813.44	
S. L. Moore & Sons' Company	5,039.27	
		$485,563.73

SURPLUS

Eastern Shipbuilding Company	$1,391.34	
Hyde Windlass Company	189,453.06	
		$190,844.40
Net Deficit being excess of Liabilities over Assets		$294,719.33

From an examination of "Schedules 6 and 7," it will appear that the alleged working capital was provided largely by the Union Iron Works, with slight help from the Hyde Windlass Company and the Eastern Shipbuilding Company.

The amount of Accounts Payable and Notes Payable of the different companies at the time of their purchase by the United States Shipbuilding Company was $2,334,987,64. Of this amount $2,192,145.98 was owing by the subsidiary shipbuilding companies other than the Union Iron Works, as appears from said "Schedule No. 7." As the principal part of the alleged working capital above mentioned was confined to Union Iron Works, it will appear that so far as the remaining companies are concerned, when taken over by the United States Shipbuilding Company, they not only had no working capital, taken collectively, but were in immediate need of financial assistance.

From the foregoing facts, viewed not only in the light of subsequent developments, but also from the figures obtainable at the time of the incorporation of the United States Shipbuilding Company, it appears to have been the intention of those responsible for the statements and figures alleged to have been relied upon to mislead and deceive the investing public and the then present and future creditors of the Company.

PROSPECTUS

In this connection, your Receiver begs to refer to the prospectus issued to the public, with a view to inducing subscriptions for the bonds of the United States Shipbuilding Company, under date of June 14, 1902. This prospectus seeks to invite the public to subscribe for nine millions of dollars of the first mortgage 5 per cent sinking fund gold bonds of the United States Shipbuilding Company. It recites that the United States Shipbuilding Company "has been organized under the laws of the State of New Jersey." It implies that the total capital stock of the Company is twenty millions of dollars, $10,000,000 of which is preferred and $10,000,000 common. It sets out a list of the directors of the United States Shipbuilding Company, numbering ten in all. It recites that the subsidiary plants of the Company, exclusive of the Bethlehem Steel Company, have been appraised as going concerns at twenty millions of dollars; that these companies would have a combined working capital of more than five million of dollars; that they have on hand contracts for work amounting to more than $36,000,000, on which the profits were estimated at over $5,000,000.

Waiving for the present all discussion as to the value of the plants as going concerns, a comparison of this prospectus with the facts disclose the following false and misleading statements:

1. At the date of this prospectus the United States Shipbuilding Company had not been incorporated.
2. Its capital stock was never Twenty Millions. Originally it was Three Thousand Dollars; which amount was subsequently increased to Forty-five Millions.

3. Six of the ten persons mentioned as directors in the prospectus were not directors of the company, and never have been.
4. The amount of contracts on hand did not exceed $36,000,000, their face value being $34,182,861.94, but of this amount a profit was available only on the uncompleted portion of the contracts, which profit, as heretofore shown, will not exceed $1,078,261.42, and will take three years to earn.
5. These companies did not have a working capital of more than $5,000,000; the figures of the accountants show only a working capital of $3,278,798.48. This working capital, however, was almost obliterated by subsequent adjustment, as hereinbefore set forth.
6. The statement that the profits on contract work in hand would be $5,000,000 was undeniably false. If it is claimed that the profit was estimated on the entire amount of $36,000,000, the answer to this is that, admitting there was $36,000,000 worth of contracts (which was not true), the utmost profit that could be looked for, according to the figures of the accountants, was $3,600,000. Whem this prospectus was issued, the persons who were responsible for it must have deliberately disregarded figures which would have shown that the amount of work still to be done on the contracts was but $20,605,639.74, instead of $36,000,000, and that upon such uncompleted work a liberal estimate would have placed the earnings at only a trifle over $2,000,000.

VALUE OF THE PLANTS

The net surplus of the various constituent companies, including their plants, according to the statement of the accountants, as shown by the books of said companies, were on the 31st day of July, 1902, as follows:

Bath Iron Works	$827,316.19	
Hyde Windlass Co.	358,121.29	
Crescent Shipyard Co.	470,583.99	
Samuel L. Moore & Sons' Co.	404,788.88	
Eastern Shipbuilding Co.	237,278.53	
Harlan & Hollingsworth Co.	1,294,767.16	
Union Iron Works	4,303,378.97	
Total	$7,896,235.01	
Bethlehem Steel Co. (deducting underlying mortgages)	4,245,281.25	
Canda Manufacturing Co. (Estimated)	300,000.00	
Total		$12,441,516.26

For this property the directors of the United States Shipbuilding Company parted with the following obligations of that company:

Preferred stock of the U.S.S. Co.	19,998,500	
Common stock of the U.S.S.Co.	24,998,500	
First Mortgage 5 per cent bonds	16,000,000	
Twenty-year gold bonds	10,000,000	
Total		$70,997,000.00

There was returned to the company, however, the following cash and securities:

Cash	$1,500,000	
First mortgage bonds	1,500,000	
Total		$3,000,000.0 0

Total bonds and stock paid by Shipbuilding company's directors for the subsidiary plants . . $67,997,000.00

In connection with the purchase of the Canda Manufacturing Company, $1,100,000 of the cash and securities of the United States Shipbuilding Company were parted with. The Canda company gave up nothing except its lands and buildings, its good will, if any, and practically all of its machinery being retained by the vendors. The above estimated value of $300,000 is undoubtedly greatly in excess of its true value. No use has ever been made of this plant, and none was apparently contemplated when it was purchased. After its purchase the directors of the United States Shipbuilding Company caused an inquiry to be made with a view to ascertaining whether it could be put to any use, and an adverse report was made. (See minutes of the directors.) Why this property was purchased at all is not apparent.

Viewing the acquisition of the properties from the standpoint of the surplus and plant values, as disclosed by the books of the companies, the directors appear to have made a gift of upwards of $55,000,000 worth of stock and bonds of the United States Shipbuilding Company entrusted to their care.

It may be clained, however, that the book values give no adequate idea of the real value of the plants as going concerns, and that the earnings of the plants should be taken into account in ascertaining such value. With reference to this matter, the minutes of the directors recite that the constituent companies, exclusive of the Bethlehem Steel Company, had an earning capacity annually of $2,225,000.00
and that the Bethlehem Steel Company was earning 1,800,000.00
Making a total earning capacity of $4,025,000.00

This statement was false, and must have been known to be so at the time the plants above mentioned were taken over. It can serve no useful purpose, therefore, in establishing value from the standpoint of earning capacity. In this connection the earnings of the past year are presented for consideration:

The earnings of all the companies for the year ending July 31st, 1903, were as follows:

Constituent companies	$833,458.74
Bethlehem Steel Company (net earnings) after deducting interest on underlying mortgages, discounts, and depreciation	1,662,530.80
Total	$2,495,989.54

A word of explanation with reference to the earnings of the subsidiary shipbuilding companies. These earnings, as to continuing contracts, are arrived at as follows: An estimate is made of the proportion of the contract completed. If this proportion should represent 50 per cent of the entire contract, and the actual cost of such percentage should be found to be 10 per cent less than the proportion of the entire contract price then earned, the profit, when such estimate is made, is put down at a figure which will repre-

sent 10 per cent of such earned proportion of the contract price. Frequently this method of arriving at profits is found to be erroneous. The percentage of completion is found to have been placed too high, and as a consequence, the profits on the entire contract are reduced much below the estimate, and, in many cases, entirely wiped out and a loss sustained.

With reference to the Bethlehem Steel Company, a different method prevails. The method of the latter company is to take profits only upon deliveries, and not to estimate earnings as the work progresses. By this method the actual profits may be arrived at.

Assuming, however, that the earnings of the constituent companies are correctly set forth above (and in the case of Bethlehem they are not understated), of what use are such earnings for the purpose of establishing values unless they are available by the United States Shipbuilding Company?

These companies claim to have earned $2,495,989.54, but the United States Shipbuilding Company has been benefited to the extent only of a trifle over twelve per cent of this amount. Of these alleged earnings the constituent companies have paid during the eleven months ending July 1, 1903, to the United States Shipbuilding Company	$60,754.23
The Bethlehem Steel Company, for the purpose of meeting the semi-annual interest on the $10,000,000 mortgage .	250,000,00
Making a total of , ...	$310,754.23

Of the $833,458.74 alleged to have been earned by the Shipbuilding companies, there has been expended for new machinery	$165,066.38
Of the earnings of Bethlehem company there was expended for plant betterment	683,370.24
There was paid by all of the companies to the United States Shipbuilding Companies, as above stated	310,754.23
Making a total of.	$1,159,190.85

The balance of the earnings (considering the above amount as having been earned) amounting to the sum of $1,336,798.69, was retained by the companies. By reason of the unsafe method of ascertaining the profits of the shipbuilding companies, it is extremely doubtful whether they have earned any such amount as above set forth. It is true, however, assuming that their earnings have been as above mentioned, that their financial condition has not been such as to warrant them in withdrawing any considerable sum from their assets for payment to the United States Shipbuilding Company.

The utmost that they could do during the past year was a trifle over seven per cent of the amount claimed by them to have been earned. The Bethlehem company, during the past year, insisted that no sum in excess of the $250,000 paid by them to meet the interest on the $10,000,000 instrument, known as the Schwab mortgage, could be withdrawn from their assets for payment to the United States Shipbuilding Company; or, in other words, that about fifteen per cent of their entire earnings was the best they could do for the United States Shipbuilding Company. Concerning the earnings of the Bethlehem, your Receiver will deal at length elsewhere in this report, but it may be said here that Bethlehem

deliberately used up its earnings in making enormous purchases of material for its own benefit, and in extensions, improvements, and repairs, in order apparently to keep its earnings from the United States Shipbuilding Company.

On the basis of what the United States Shipbuilding Company received from all the companies last year, there would be sufficient income only to meet the interest, at five per cent, on an investment of a trifle over $6,000,000. It may be insisted that this is not the best the companies can do, and therefore this amount should not be taken as a guide in establishing the value of the plants. Your Receiver is satisfied that it is not the best the companies can do, especially in the case of Bethlehem. It is certain that better returns would have been received from the constituent companies if they had been brought within closer reach of the central company, and if officers had been placed in charge who had looked to the interests of the central organization and not wholly to the betterment of the constituent companies. It is undoubtedly true that the fastening upon the constituent companies of certain officials, at fixed salaries, and for a long term of years, practically beyond the reach of the central organization, has materially prevented the United States Shipbuilding Company from obtaining the best results from its properties. In the case of the Bethlehem, a Board of Directors having the welfare of the United States Shipbuilding Company at heart, rather than its destruction, would have conduced much to the gain of the latter company. With these defects in management removed, the earning capacity of all the companies, so far as the United States Shipbuilding Company is concerned, would be greatly enhanced.

At the end of eleven months of operation, the United States Shipbuilding Company was adjudged insolvent and a receiver appointed. This was due either to the fact that the earnings were insufficient to meet its obligations, or because those earnings were improperly diverted. Your Receiver will hereinafter discuss this matter, but under this head he respectfully submits that the earnings of the several companies during the past year may not safely be used for the purpose of establishing the value of the plants.

EXCESSIVE PRICE PAID FOR PLANTS

Considering the value of the plants, therefore, either from the standpoint of the books, or the earning capacity of the companies, and allowing for an increase in earnings in the future, it is evident that the accommodating directors of the United States Shipbuilding Company, in acquiring these properties, deliberately gave away many million dollars in the stock and bonds of their Company.

Who participated in this wholesale plunder? The testimony now being taken in the above entitled proceedings will doubtless disclose the name of all the participants; but as such testimony will be submitted to this Court for action, your Receiver does not deem it proper to comment upon it here. Certain it is that much of this vast amount of stock and bonds was taken by persons and corporations who parted with little or no consideration in exchange therefor. Blocks of the stock went to the vendors of the constituent plants and to the purchasers of bonds, as bonus, absolutely without benefit to the Company; $20,000,000 of it admittedly went to Mr. Charles M. Schwab in addition to the agreed price for

[illegible] States Shipbuilding Company.

[illegible] the books of what the United States Shipbuilding Company [illegible] from all the companies last year; there would be sufficient [illegible] only to meet the interest, or five per cent. on its investment of a little over $1,000,000. It can be imagined that [illegible] it was the best the companies did [illegible] and taken as a guide in establishing the value of the [illegible]. Your Receiver is satisfied that it is not the best the companies can do, especially in the case of Bethlehem. It is certain that better returns would have been received from the companies if they had been managed [illegible] clever [illegible] of the [illegible] company, and if officers had been placed in charge [illegible] to the [illegible] of the central organization and not merely [illegible] of the constituent companies. It is undoubtedly [illegible] the [illegible] upon the constituent companies of [illegible] and for a long term of years, [illegible] beyond the reach of the central organization, [illegible] converted the United States Shipbuilding Company [illegible] the best results from the properties. [illegible] a Board of Directors having the welfare of the [illegible] States Shipbuilding Company at heart [illegible] would have produced much better [illegible] in management [illegible] the earning capacity of [illegible] as far as the United States Shipbuilding Company is concerned, would be greatly enhanced.

[illegible] end of eleven months of operation, the United States Shipbuilding Company was adjudged insolvent and a Receiver appointed [illegible] either to the [illegible] collections, or [illegible]. Your Receiver [illegible] this head the [illegible] that the operations of the companies during the past year may not safely be taken for [illegible] of establishing the value of the plants.

[illegible]

Considering the value of the plants, therefore, either from [illegible] of the books, or the earnings [illegible] of the companies, and allowing [illegible] they are [illegible] in the future, it [illegible] that the [illegible] directors of the United States Shipbuilding Company, in acquiring these properties, deliberately [illegible] many million dollars in the stock and bonds of the [illegible].

[illegible] plunder? The testimony [illegible] however, but as much [illegible]. Your Receiver [illegible] $[illegible]. Certainly it is [illegible] was taken [illegible]

Bethlehem. Some of it went to the promoters of this artistic swindle; and when all had been provided for, what was left of the bonds, amounting to $1,500,000, was handed back to the Company ostensibly to supply it with "working capital."

From the foregoing statement as to values, it is apparent that the $24,500,000 of bonds given up by the directors was an excessive price for all the plants purchased. Your Receiver is advised that as to the $44,997,000 of the preferred and common stock handed over by the directors to the vendors and promoters of this scheme, it cannot successfully be maintained that any value was paid therefor. Treating the issue of bonds, therefore, as full payment for the properties (and in so doing the Shipbuilding company alone is being injured), it follows that the vendors and promoters and their associates in the transfer and conveyance of the various plants to the United States Shipbuilding Company, by the acceptance of this $44,997,000 of the capital stock of the Shipbuilding company, without paying value therefor, became liable thereon to said corporation, by virtue of the provisions of section 21 of an act of the Legislature of the State of New Jersey, entitled an act concerning corporations (Revision of 1896). The United States Shipbuilding Company was entitled to recover such indebtedness from the holders of such stock and your Receiver is advised that he is entitled to enforce the same. Accordingly, your Receiver has offset against the sum alleged to be due on the $10,000,000 mortgage to the New York Security and Trust Company as trustee, to protect the issue of bonds to Charles M. Schwab, the liability of the said Charles M. Schwab on the $20,000,000 of stock received by him as aforesaid, and has interposed an answer in the suit by said trustee to foreclose the mortgage given as security for said bonds, claiming that by virtue of said offset the total issue of said bonds has been fully paid and satisfied. As to the issue of the bonds under the mortgage for $16,000,000 made to the Mercantile Trust Company, your Receiver charges that many of said bonds were received by the vendors and promoters and their transferees, and were issued by said Mercantile Trust Company, with full knowledge of the right of the United States Shipbuilding Company to be paid for the common and preferred stock taken by said vendors and other holders of said bonds without value, and as to all bonds secured by said mortgage so received, your Receiver has offset against the amount alleged to be due thereon, the liability of the holders thereof on the common and preferred stock so received by them, or their transferrers, and has interposed an answer in the suit instituted by the Mercantile Trust Company to foreclose said mortgage, claiming that by virtue of such offset the total issue of said bonds, or the principal part thereof, has been fully paid and satisfied.

CULPABILITY OF THE UNITED STATES SHIPBUILDING COMPANY's DIRECTORS AND OTHERS

Your Receiver has spoken of the directors of the United States Shipbuilding Company as if they were wholly responsible for partinging with many million dollars in the stocks and bonds of the United States Shipbuilding Company without value. The directors who were guilty of this act are responsible and should be held accountable for their unlawful act; but they are not alone responsible. In the first place, they were not bona-fide holders of the stock of the United States Shipbuilding Company. They were clerks selected by the promoters of this scheme from the Corporation Trust Company. They took an assignment of a subscriptive right to a share of stock, and upon the strength of this alleged subscription

they dealt with the property of the United States Shipbuilding Company in the manner above recited. These young men were mere figureheads, placed in this position in order that the scheme of others might be carried into effect. This scheme was placed before them by its instigators, through the medium of an alleged offer of John W. Young, and the so-called directors in conformity with their instructions, and, without the ability or the knowledge to pass upon the matters therein contained, proceeded to do as they were told. Your Receiver charges that the properties of the various constituent companies were sold to the United States Shipbuilding Company for an amount which the vendors of such properties, at the time of such sale, knew to be far in excess of the fair value of said plants; and that the plan to combine such properties was conceived by certain promoters and was consummated by them with full knowledge of its injustice to the United States Shipbuilding Company.

Your Receiver begs to direct the attention of the Court to the fact that in the purchase of the various constituent companies, the United States Shipbuilding Company was absolutely without independent and intelligent representation. No inspection of the properties was made on behalf of the Shipbuilding company. No independent appraisement was had. No steps seem to have been taken by any one with a view to protecting the interests of the United States Shipbuilding Company. The directors who purported to act for the Company were the tools of the promoters; the debts of the constituent companies, aggregating $2,334,987.64, seem to have been purposely withheld, and the bonds and stock of the United States Shipbuilding Company were placed wholly at the mercy of the vendors and promoters.

OPERATION OF THE UNITED STATES SHIPBUILDING COMPANY

Under such auspices the United States Shipbuilding Company began operations. On paper the constituent companies had a working capital in excess of $3,000,000, yet offices had hardly been secured by the United States Shipbuilding Company before the latter company was compelled to assist the constituent companies to pay their debts. The alleged working capital of the constituent companies existed on paper only. It was made to appear as available capital in order that the sale might be consummated. After such sale there was no longer any necessity for the continuance of this pretence, and accordingly demands for remittances began to pour into the central organization. During the eleven months ending July 1, 1903, the United States Shipbuilding Company was compelled to advance to the constituent companies the sum of $1,019,955.78. Of this amount $60,754.23 was returned to the Company, making the net amount advanced to the constituent companies $959,201.55. In addition to this sum it was compelled to part with $520,000 of the bonds which had been placed with it as working capital, for the purpose of securing indorsements on promissory notes which the United States Shipbuilding Company was required to make for the accommodation of the constituent companies.

The reason for this has been herein elsewhere suggested. When the various properties were purchased, the debts of such companies were not disclosed. Had there been independent, intelligent representation on the part of the United States Shipbuilding Company in connection with the acquisition of these properties, it would have been discovered that the new company was taking over $2,334,987.64 of debts, a considerable part of which called for immediate attention. Had there been such representation, it would

have been disclosed that the companies had practically no working capital except such as they might receive from their vendee, and with this knowledge the wholesale delivery of bonds and stocks of the United States Shipbuilding Company would undoubtedly have been averted. But there was no one in that transaction to protect the interest of the new company, and as a consequence it was not only made to pay excessive prices for the property purchased, but obligations were assumed by reason of this vast amount of debt that practically exhausted the resources of its treasury.

While the bills of sale from the various constituent companies purported to transfer all the personal property of such companies to the United States Shipbuilding Company, including their cash, amounting to the sum of $389,317.57 (exclusive of Bethlehem), this amount was retained by the various companies when the leases above mentioned were made, and no benefit therefrom was ever received by the United States Shipbuilding Company, except the doubtful one of allowing this amount to help swell the alleged working capital of the constituent companies.

The United States Shipbuilding Company was not fairly organized until some time in September, 1902. On the 24th day of December, 1902, with a view to inducing the New York Stock Exchange to list the entire stock and bond issue of the Company, amounting to $69,500,000, a statement was made to such exchange, over the signature of A. C. Gary, treasurer of the United States Shipbuilding Company. This statement recites that theearnings of the subsidiary companies, exclusive of the Bethlehem Steel Company, for the year ending June 30, 1902, amounted to the sum of $1,942,522.03 and that the net earnings of the Bethlehem Steel Company for twelve months ending July 31, 1902, amounted to the sum of $1,441,-208.03. Without taking time to controvert this statement, which was clearly erroneous, and which, upon a proper examination, would have been shown to be so, an allegation appears in this statement of far more serious import. It is therein alleged that the net earnings of the United States Shipbuilding Company and the Bethlehem Steel Company for the three months ending November 30, 1902, amounted to the sum of $1,163,022.22. Of this amount the United States Shipbuilding Company was said to have earned up to that time $554,021.45, and the portion earned by the Bethlehem Steel Company was placed at $609,000.77. These earnings were said to be net; but in the case of the Bethlehem Steel Company no allowance was made therein for depreciation, and, furthermore, such earnings constituted no basis for averaging the annual profit, as the later report of the Bethlehem Steel Company shows. In the case of the United States Shipbuilding Company, the earnings existed on paper only, as appears from subsequent reports. Your Receiver believes that the officials of the United States Shipbuilding Company did not know that erroneous reports were being made to them by the constituent companies, but their action was at least injudicious in so wording the statement to the Stock Exchange as to impel the inference that the earnings of the United States Shipbuilding Company up to the 30th day of November, 1902, were available for the purpose of meeting the accrued interest and sinking fund payment on all bonds of the company for that quarter, for during the very time within which the alleged earnings of $554,021.45 had been made by the subsidiary companies, and which the statement infers were available for the payment of all accrued interest and sinking fund charges, they had been compelled to advance in cash to the constituent companies the sum of $424,467.59.

In this showing the application to list the securities was granted by the New York Stock Exchange on January 14th, 1903. A little over four months later, on the 25th day of May, 1903, a statement was issued to the public embodying a plan for the reorganization of the United States Shipbuilding Company upon a basis that would enable it to exist. This proposed plan of reorganization stated that "by reason of the excessive mortgage obligations of the United States Shipbuilding Company, its borrowing capacity and credit has become so seriously affected that outstanding notes are being pressed for payment and the making of further loans is rendered impossible," and recommended that the Company should be reorganized upon a basis of almost 40 per cent less than was originally considered the fair value of the plants. If other evidence than the figures above set forth be needed to prove that vendors and promoters of this scheme sought to secure stocks and bonds of the United States Shipbuilding Company without consideration, it is supplied by this proposed Plan of Reorganization, which practically states that the Company is unable to pay interest on a greater capitalization and bond issue than $43,000,000, an amount $1,487,000 less than the capital of the United States Shipbuilding Company distributed in connection with the purchase of the properties, to say nothing of the bond issues of $24,500,000.

CAUSES OF FAILURE

What were the causes of failure of the United States Shipbuilding Company? One of such causes was the fact that the directors parted with bonds to an amount upon which it was impossible to meet the interest. The failure, however, was precipitated, if not directly brought about, by the fact that in the Bethlehem transaction the United States Shipbuilding Company officers had to deal with people who, while thoroughly understanding the intricacies of "higher finance", seemed to have overlooked the requirements of common fairness. In speaking of plant values elsewhere in this report, the Bethlehem property has been dealt with as though it had been purchased by the United States Shipbuilding Company, but an examination of the transaction will show that it was otherwise. While the agreed price for the Bethlehem company was $9,000,000, to be paid for by an issue of $10,000,000 of bonds at 90, the directors of the United States Shipbuilding company, upon request, handed over to Mr. Charles M. Schwab an additional amount of $20,000,000 in the common and preferred stock of the United States Shipbuilding Company. As this $20,000,000 of stock would not be sufficient to give Mr. Schwab the control of the United States Shipbuilding Company, there was inserted in the mortgage given to secure his $10,000,000 of bonds, a provision that such bonds should have a voting power equal to $10,000,000 of stock. As the total issue of stock of the United States Shipbuilding Company was but $45,000,000, the $30,000,000 voting power thus given to Mr. Schwab was sufficient to justify him in saying that he did not sell the Bethlehem Steel Company, but took over the United States Shipbuilding Company, the directors of that Company giving him $30,000,000 in stock and bonds for taking it off their hands.

In this deal Mr. Schwab parted with nothing. In the sale of the other constituent companies, the real and personal property, as well as their capital stock, were transferred to the United States Shipbuilding Company by the necessary deeds, bills of sale, and assignments. But in the case of Bethlehem, Mr. Schwab permitted to be given up only its capital stock, and this he did in such manner as to place it beyond the control of the Shipbuilding company. If

interests friendly to the United States Shipbuilding Company had controlled this stock, it would have been able to reach the earnings of the Bethlehem Steel Company through a friendly Board of Directors; but in the $10,000,000 mortgage it was provided that the Trustee should designate three of such directors, and the United States Shipbuilding Company should designate four. As Mr. Schwab controlled the United States Shipbuilding Company, by reason of his aforesaid majority of stock, and as the Trustee was of his own selection, the United States Shipbuilding Company was absolutely at the mercy of Mr. Schwab. His advisers, however, in evident fear that something had been overlooked, caused the United States Shipbuilding Company to execute a contract wherein it agreed and guaranteed that so long as any part of the $10,000,000 issue of bonds above referred to should be outstanding and unpaid, the Bethlehem company should pay dividends on its entire outstanding capital stock at the rate of not less than six per cent per annum, and for the purpose of making such payments the Shipbuilding company agreed that the Bethlehem company should earn, over and above its operating expenses and fixed charges (including interest on its bonds and taxes), and over and above the working capital of $4,000,000 therein provided for, a sum sufficient to make such annual dividend disbursements; and, in the event of the failure of the Bethlehem company earning sufficient to pay such dividend at the rate of six per cent, then the United States Shipbuilding Company was to pay to the Bethlehem company, on demand, a sum sufficient to make such annual dividend disbursements. The Shipbuilding company further agreed to supply the Bethlehem company with all such orders, contracts, work and earning capacity as should be necessary to enable it to earn and pay the annual dividends above mentioned. Was ever such another agreement, so apparently harmless, yet so ruinous, conceived by the mind of man? On its face it was simply an agreement to the effect that if sufficient earnings were not made by the Bethlehem to pay a dividend of 6 per cent on its capital stock, the United States Shipbuilding Company would advance such sum. This agreement was an absurd arrangement, in view of the fact that the United States Shipbuilding Company was the nominal owner of this stock,and as such was entitled to its dividends; nevertheless the United States Shipbuilding Company was made to agree in éffect that if it wanted dividends from Bethlehem it should contribute the means to enable the payment of such dividends. An excuse for the United States Shipbuilding Company officials entering into such an agreement might be found in the supposition that they may have believed that as they had the right to designate four of the seven directors of the Bethlehem Steel Company, they would be able to control the earnings of that company, and the agreement above mentioned might become inoperative. Such a belief, however, had no substantial foundation, for, as heretofore stated, the control both of the Bethlehem and the United States Shipbuilding Company was vested in Mr. Schwab. Your Receiver will not attempt to advance any reason why the latter thought it necessary to take any such agreement in view of the fact that he had previously thereto obtained a control of the Shipbuilding company that would enable him at any moment to throttle it. As if the foregoing provisions in said agreement were not sufficient, the United States Shipbuilding Company was further made to agree that in the event that the working capital of the Bethlehem Steel Company should at any time fall below $4,000,000, the United States Shipbuilding Company would, upon demand, make up such sum as might be necessary to bring the working capital up to that figure. The agreement contains other provisions, all operating against the United States Shipbuilding Company, but enough has been referred to to show that in signing it the United States Shipbuilding Company had lost all chance of ever reaching the

earnings of the Bethlehem Steel Company. For, assuming that Mr. Schwab's directors of the United States Shipbuilding Company should demand of Mr. Schwab's directors of the Bethlehem Steel Company that a dividend be declared from the earnings of the latter company, Mr. Schwab's directors of the Bethlehem Steel Company could always reply (as they did when demand was made) that it was not considered wise to declare a dividend at that time.

In April, 1903, it became apparent that unless funds were advanced by the Bethlehem Steel Company for the purpose of meeting the semi-annual interest on the first mortgage bonds due July 1st, a default in the payment thereof would ensue. Notwithstanding the urgent need apparent at that time for retrenchment, and the necessity for requiring Bethlehem to set aside some of its large earnings for the purpose of meeting the coming interest, the Executive Committee of the United States Shipbuilding Company, on the 7th day of April, 1903, adopted a resolution approving a report of the president of the Bethlehem Steel Company with reference to certain improvements and extensions alleged to have been required at the works of the latter company, showing a total required expenditure of $2,802,000 (including $365,000 previously appropriated). On the 14th day of April, 1903, the directors of the United States Shipbuilding Company held a meeting, at which time it was sought to approve the minutes of the previous meeting of the Executive Committee. On a motion to approve such minutes, Mr. Lewis Nixon, the president of the company, stated that he desired to go on record concerning the resolution passed, to the effect that in providing for any such extensions and improvements it should be made a condition of any such expenditure that proper provision should be made to safeguard the amount of $900,000, which must be declared as a dividend by the Bethlehem company, and suggested that provision to that effect be added to the authority asked for. Notwithstanding this request of Mr. Nixon, the minutes of the Executive Committee were approved by the directors.

Your Receiver is informed, and believes it to be true, that thereafter Mr. Lewis Nixon repeatedly sought to induce the directors of the United States Shipbuilding Company to cooperate with him in compelling the Bethlehem company to pay over some of its earnings for the purpose of staving off the impending default of the United States Shipbuilding Company; but from the 14th day of April, 1903, until the 22d day of June, 1903, it was impossible to obtain a quorum either of the Executive Committee or of the directors of the United States Shipbuilding Company. Again, on the 27th of June, while the proceedings were pending in this court for the appointment of a Receiver, Mr. Nixon demanded the Bethlehem Steel Company's assistance for the purpose of averting the impending default, through the medium of the following letter:

New York, June 27th, 1903

E. M. McIlvain, Esq.,
President Bethlehem Steel Company,
South Bethlehem, Pa.:

Dear Sir:--The Bethlehem Steel Company, having earned during the year ending August 1st, 1903, over and above its operating expenses and fixed charges (including interest on its bonds and taxes), and without impairment of its working capital of $4,000,000, a sum sufficient to pay a dividend of 6 per cent on its entire present outstanding capital stock, I request and demand, in behalf of the United States Shipbuilding Company, as owner of all of said capital stock, that your company, on or before June 30, 1903, declare a dividend

in an amount sufficient to pay a bond interest of $362,500, due July 1st, 1903, and pay the same as required by the terms of the agreement of August 12th, 1902, between your company and the United States Shipbuilding Company, and credit this upon the yearly dividend on the stock of the Bethlehem Steel Company, $250,000 of which has already been declared and paid in a similar manner to meet the interest on the twenty-year bonds.

Yours truly,
(Signed) LEWIS NIXON,
President

No attention was paid to this demand, and the default followed. Had the efforts of Mr. Nixon been successful, the subsequent adjudication of insolvency and the appointment of a receiver would have been averted.

Your Receiver considers it his duty to bring to the attention of the Court the fact that while the Bethlehem company was earning upwards of $2,000,000 annually, these earnings were being placed beyond the reach of the United States Shipbuilding Company by the making of vast extensions and improvements in the Bethlehem company and the purchasing and ordering of enormous quantities of merchandise, with the apparent purpose of bringing about the destruction of the United States Shipbuilding Company.

Further proof in this behalf is supplied by Mr. E. M. McIlvain, President of the Bethlehem Steel Company, in his letter to Mr. George R. Sheldon, Chairman of the Reorganization Committee. In this letter, dated the 25th of May, 1903, Mr. McIlvain states that during the fiscal year of the Bethlehem Steel Company ending April 30th, 1903, the net earnings of his company were $2,518,264.58. In the third paragraph of this letter he states that for the year beginning May 1, 1903, a conservative estimate of the net earnings of the Bethlehem Steel Company would be about $2,250,000 after deducting $517,550 of earnings for the purpose of paying interest on the underlying mortgages. Of this amount of earnings, he states, in the fourth paragraph of his letter, that he feels confident that there could be withdrawn for distribution (for dividends) the sum of $1,200,000. During the year within which Mr. McIlvain says the net earnings of the Bethlehem Steel Company were $2,518,264.58, the utmost that the Bethlehem Steel Company could be induced to give up to the United States Shipbuilding Company was $250,000. But in presenting the matter to the public, through the medium of the Reorganization Committee, and with a view to inducing the acceptance of a plan that would further the interests of Mr. Schwab, he states that from the earnings which are not in excess of the fiscal year ending April 30, 1903, he would be able to withdraw and pay over to the reorganized company a sum almost five times as much as his company was able to do when there was the utmost need for its greatest contribution. Your Receiver is unwilling to believe that Mr. McIlvain would deliberately make a false statement in this connection. He is also willing to accept his statement that the Bethlehem company would be able to withdraw from its current assets the sum of $1,200,000 for distribution during the year beginning May 1, 1903, but in accepting this statement and considering it in connection with the fact that all Bethlehem would advance during the past year was $250,000, and bearing in mind that the major part of the improvements and extensions above authorized were to be completed in subsequent years, it is difficult to draw any other conclusion than that the earnings

of Bethlehem company during the past year were deliberately withheld for the purpose of wrecking the United States Shipbuilding Company. During the year ending July 31, 1903, Bethlehem expended for addition to its plant the sum of $683,370.24. In addition to this amount it expended for extraordinary and general repairs, during the year ending April 30, 1903, according to the report of Price, Waterhouse & Co., the sum of $450,000. It increased its material (unfinished and finished product and stores) $687,149.16. Its notespayable, which amounted to $350,000 when the stock of this company was attempted to be purchased by the United States Shipbuilding Company, were reduced $200,000 up to August 1, 1903, and have since been entirely wiped out, and finally it reduced its accounts payable to the extent of $179,468.22. Why such enormous sums should be expended for additions, repairs, and material at a time when the United States Shipbuilding Company was in urgent need of financial aid can be reasonably accounted for only upon the theory that it was in conformity with a deliberate plan to provide a plausible excuse for having withheld all dividends when the crash should come in the affairs of the United States Shipbuilding Company. Some attempt has been made by Bethlehem to justify its retention of its earnings by the statement that its credit had become impaired, and it was therefore necessary to pay cash for supplies, as well as to reduce its accounts and bills payable in order to placate its creditors. The alleged cause of the impairment of credit was said to be a mortgage for $10,000,000 which the Bethlehem company made to the Colonial Trust Company upon its plant and property at the time of the purchase of Bethlehem by the United States Shipbuilding Company. As further security to Mr. Schwab for the $10,000,000 of bonds delivered to him as the purchase price of Bethlehem, the Bethlehem Steel Company executed to the Colonial Trust Company the mortgage above referred to to secure a bond in the like amount. Your Receiver is advised that the execution and delivery of such bond and mortgage by Bethlehem to secure Mr. Schwab for the purchase price of the sale of the stock of the Bethlehem was a fraud upon the creditors of said company, and was otherwise void because of the control of the directors by Mr. Schwab. In addition thereto, it is evident that the impairment of credit, if any, which Bethlehem complains of, was the result of its own deliberate, unwarranted, and illegal act. Your Receiver submits, therefore, that there was no justification for withholding from the United States Shipbuilding Company the entire earnings of the Bethlehem company, and charges that the inability of the Shipbuilding company to continue its business was due in large part to the failure of the Bethlehem company to relinquish its earnings.

At this point your Receiver desires to call the attention of the Court to another matter somewhat small in comparison with the enormous and unlawful appropriation of stocks and bonds of the United States Shipbuilding Company above mentioned, but of some importance in showing the manner with which the Bethlehem Company dealt with the United States Shipbuilding Company. At the time of the sale of the Bethlehem Steel Company to the United States Shipbuilding Company, a statement was made that the amount of inventory was a certain figure. After the sale of the Bethlehem company to the United States Shipbuilding Company, $250,000 of this amount was charged off by the Bethlehem company, for the purpose of adjusting the book value of the inventory with the actual value which had been placed thereon by the accountants after examination. This examination had been made in April, 1902, and the Bethlehem company had been instructed at that time to charge off, to adjustment of inventory, $609,541.95. Instead of complying with this request, they

charged off only $359,541.95, and at the time of the sale of the plant to the United States Shipbuilding Company the statement submitted contained a surplus $250,000 in excess of what Bethlehem knew to be the actual amount.

Still another matter should be brought to the attention of the Court. On the 22d of June, 1903, while proceedings were pending for the appointment of a receiver of the Shipbuilding company, and, as it seems to your Receiver, with a view of forestalling the action of the Court, and in contempt thereof, the directors of said Company adopted a resolution, as provided for under Mr. Schwab's mortgage, requesting the New York Security Trust Company to vote the entire shares of the capital stock of the Bethlehem Steel Company in favor of and for the following persons, as directors of said Bethlehem Steel Company, namely, E. M. McIlvain, Archibald Johnson, Adolphe E. Borie, and Lewis Nixon. Mr.McIlvain was at that time and is now the President of the Bethlehem Steel Company; Mr. Borie w s and is the VicePresident of the Bethlehem Steel Company, and Mr. Johnson was and is the General Superintendent of said Company. As the remaining directors were selected by Mr. Schwab's trustee, it is apparent that but one of the seven could be said to represent interests other than those of Mr. Schwab. By this means, if successful, Mr. Schwab was able to place the control of Bethlehem beyond the reach of the Court for at least another year.

BETHLEHEM STEEL COMPANY

From the reports submitted by the officials of this Company, it is evident that during the past year it earned far more money than the necessities of the plant required to be retained there. From what is hereinabove set forth, it is also evident that so long as the present Board of Directors, or a Board subject to present influences, shall retain office, no benefit shall ever be permitted to escape to the Receivership. Your Receiver is convinced that the present controlling influence at this plant is wholly hostile to the Shipbuilding company and its representatives, and your Receiver believes, in view of the excessive price paid for its plant, that the Shipbuilding company, or its representatives, should be permitted to have at least some voice in its management. At present this is denied, but your Receiver hopes that such action may be taken as may result in the removal of the present Board of Directors, or a majority of them. Your Receiver believes that the meeting of the Board of Directors of the United States Shipbuilding Company, held on the 22d day of June, 1903, and hereinbefore referred to, at which four directors were designated to represent the United States Shipbuilding Company on the Board of the Bethlehem Steel Company, was solely for the purpose of circumventing any order of this Court which might be made in the proceedings than pending; that it was intended to hinder and delay the creditors of the United States Shipbuilding Company and to place this property beyond their control and the control of the Receiver to be appointed, and was otherwise illegal and void. Your Receiver believes such Board is deliberately furthering a course at once illegal and greatly injurious to the creditors represented by your Receiver, and accordingly he makes the recommendation concerning this Company hereinafter set forth.

GENERALLY

Since the appointment of your Receiver the principal office has been engaged in legal matters rather than building ships. Accordingly

your Receiver found the services of several of the officers and subordinates of the Shipbuilding company to be unnecessary, and in this connection has reduced expenses upwards of $55,000 a year.

RECOMMENDATIONS

Your Receiver respectfully submits the following recommendations:
1. That in order to avoid depreciation by disuse, and because of the existence of controversies as to the validity of the encumbrances upon the premises, the Crescent Shipyard be sold free and clear of all such encumbrances as soon as the work now in contemplation is completed.

2. That similar action be taken with reference to the plant of the Harlan & Hollingsworth Company, Wilmington, Delaware.

3. That as soon as the debts of the company shall have been ascertained suit be instituted against all persons who received the stock of this company without paying full value therefor to recover from them such an amount as shall be necessary to pay said debts in full, under section 21 of an act of the Legislature of the State of New Jersey, entitled, An Act concerning Corporations (Revision of 1896).

4. That suit be instituted against the Bethlehem Steel Company to procure the appointment of a Receiver and to compel the appropriation of the earnings of that company by way of dividends on the stock.

Respectfully submitted,

James Smith, Jr.,

Receiver, United States Shipbuilding Company

Dated October 31, 1903.

THE RELATION OF THE FINANCIAL TRUST COMPANY TO THE INDUSTRIAL TRUST

By L. Walter Sammis

At the outset I desire, without any reservation, to emphasize my position; namely, that I deal with this topic in my personal capacity, and not in any sense as representing any other body or bodies of men, and without in any wise reflecting the views of any one else.

It is my good fortune to be a member of the editorial staff of the New York Sun, but it must be distinctly understood that neither the substance nor the language of my address has been submitted to any of my associates, nor is the New York Sun in anywise responsible for my statements.

It is equally important that my position shall be clearly understood as to combinations of capital, commonly called trusts, and also as to "trust companies," both actual and nominal.

Whatever may be said in this address with reference to the morale of the Shipbuilding Trust, must not be understood as defining, or even reflecting my attitude towards all combinations. I am not an anti-trust man. I do not take the position that the combination movement in itself is bad, or that all combinations are necessarily wrong or evil-producing in their results, and it is too palpable to require affirmation, not only that trust companies were originally fiduciary institutions, but also that many of them remain so in the true sense of the word today.

Industrial combinations are not the natural result of business conditions; neither are they the pure outgrowth of economic principles. Trusts are made, not born. They are creatures of invention which find their origin in the brain of the industrious promoter whose inventive faculties are stimulated by the desire to possess unearned wealth. "Necessity is the mother of invention," even as applied to the invention of a trust, but the necessity in this case is not the necessity created by economic laws, but the necessity of the promoter. Trust companies and similar institutions sometimes bear the same relation to industrial combinations as manufacturers do to the product of the mechanical or scientific inventor's brain. They label it, give it place on the market, compensating themselves by getting the largest obtainable profit for the least possible risk or responsibility.

Originally trust companies were strictly fiduciary institutions. They partook of the character of the name "Trust." They took charge of estates and managed them; they were custodians of mortgages, fiscal agents for railroads and other large combinations of capital; they attended to all the affairs pertaining thereto and transacted business solely of a fiduciary nature. They were managed with a conservatism creditable to our fathers and admired by ourselves. I am not to be misunderstood as saying that none of the old line trust companies are in existence. They can be distinguished readily by the character of their officers and the kind of business they transact.

Modern times, lax, but so-called up-to-date, methods have permitted conditions different from those under which the old-line companies did business.

Some of these methods would shock the ordinary outsider, but High Finance has a code all its own, fitting the business processes

of its adherents, elastic, pliable and capable of such construction that a financier is never guilty of an offense so long as there are no complaining losers. In the powerful financial centers some operators deny the truth of the axiom that the shortest distance between two points is a straight line. Mathematically the axiom may be true, but in High Finance the shortest distance between two points is the way by which the greatest amount of money can be made. Regardless of the number of crooks and turns that are in this line, according to a certain class of High Finance ethics, it is as straight as a string drawn taut. It is my purpose to point out some of the ramifications in one of these so-called straight lines.

Through the protracted legal proceedings against the United States Shipbuilding Company, the public has had an opportunity to observe the methods by which an industrial combination was actually financed.

A photograph of how it was done, rather than a thesis on how it should be done, is the result.

The United States Shipbuilding Company is claimed to have been incorporated under the laws of the State of New Jersey by dummies furnished for the occasion on June 17, 1902, with a subscribed capital of $3,000. On July 3d following, the capitalization was, on paper, increased to $45,000,000 in stock and $26,000,000 of bonds. On the 11th and 12th of August the United States Shipbuilding Company purchased the Union Iron Works, The Bath Iron Works, Limited, The Hyde Windlass Company, The Crescent Shipyard Company, The Samuel L. Moore & Sons Company, The Eastern Shipbuilding Company, The Harlan & Hollingsworth Company, the Canda Manufacturing Company and the capital stock of the Bethlehem Steel Company, paying for them $6,000,000 in cash, $14,050,000 of bonds and $28,000,000 of stock. The entire amount of securities disposed of to acquire these companies and to provide $15,000,000 working capital and to pay the profits of the various persons and institutions concerned in the promotion amounted, at par value, to $69,500,000. For this bouquet of fortunes the combination received, besides the reputed cash working capital of $1,500,000, constituent companies which, omitting the Bethlehem Steel Company, were valued later by competent men at $12,441,518.26. The Mercantile Trust Company was custodian of a first mortgage on the plants for $16,000,000 and the New York Security and Trust Company was custodian of a collateral mortgage of $10,000,000 on the capital stock of the Bethlehem Steel Company, which was, besides, a second mortgage on the Shipbuilding plants. It will be observed that the first financial institution having relations with the United States Shipbuilding Company was the Mercantile Trust Company, the attorneys of which were Messrs. Alexander & Green.

The Trust Company of the Republic was then asked to become banker for the issue of the bonds, and it, with the Mercantile Trust Company, played important parts in the undertaking. The Trust Company of the Republic, through its president, advanced large sums of money, much of which was obtained by borrowing on Shipbuilding securities countersigned by the Mercantile Trust Company as registrar. When the crash came the Trust Company of the Republic was able to figure up a cash loss of $982,334.

With the fall of the United States Shipbuilding Company my story has nothing to do. My theme is the methods by which it was established, false and insecure as that establishment was, and my story must end at the point where it was left to stand alone, for at that point it

reached its climax.

To a full understanding of the matter, it is necessary to take up the tale at the beginning.

John W. Young, whose father, Brigham Young, succeeded Joseph Smith as the head of the Mormon Church, arrived in New York in the closing year of the nineteenth century with a theory. He was a promoter who had not met unvarying success in his many previous ventures, but, like all promoters from Col. Sellers down, he possessed the faculty of dreaming dreams and telling them so convincingly that they lost their element of unreality and took upon themselves the semblance of established facts in the minds of his listeners. Young had the idea that it would be a good stroke of business to combine the leading shipbuilding industries of the country into one gigantic corporation, and had worked out a theory by which it could be done with much profit to the promoters.

Young's idea was good, but his method, which he made inseparable from his idea, was bad. But it was spangled with prospective coins, glittering with possibilities and laden with immense prospective fortunes. After many futile attempts, he succeeded in finding a group of men who were willing to listen while he exploited his idea and expounded his theory. These men accepted his theory, and adopted his method, and, using it as a base, constructed thereon a situation which they called a trust, and which was incorporated under the name of the United States Shipbuilding Company. The theory was impossible; the situation was untenable; the trust, as it was manufactured, was impracticable, and the United States Shipbuilding Company was insolvent.

The financial world was absorbed at that time in creating industrial combinations, some of which were either actually bankrupt or were on the verge of bankruptcy; inflating values and watering stocks; successfully offering new securities to a public riotously eager to buy them, and finally dividing with promoters and vendors, profits which, even in that era of inflation, were considered enormous. Young knew that his plan was richer in paper profits than any that had been brought to a successful issue, with the possible exception of one, and that it had large fortunes to scatter among the men who might assist him to develop it into an accomplished fact, so far as obtaining the money of the investor and the speculator for elegantly lithographed pieces of paper was concerned. He talked of it and wrote it on paper; he had it printed in the terms best appreciated by financial chieftains--a dollar mark and seven or eight figures on the left hand side of the decimal point. But he got no real start until he met Lewis Nixon.

Mr. Nixon had been a constructor in the United States Navy, but had resigned from the service to engage with the Cramps. As a naval constructor he designed the Oregon, the Indiana and the Massachusetts and these vessels established his reputation as one of the ablest shipbuilders in the world. Before he met Young he purchased the Crescent Shipyards at Elizabethport, N. J., for about $7,000, organized a company, capitalized for $1,120,000, retaining in his own name all the stock except so much as was required to qualify directors. Young interested Nixon by showing him an option for the purchase of the Newport News Shipbuilding and Dry Dock Company, and Nixon gave him an option on his own plant and agreed to work with him in forming the proposed combination. This was the start. Young now had two options and the name and reputation of the greatest ship-

builder of the United States to work with.

He had the co-operation of Col. John J. McCook, a director in the Mercantile Trust Company and as well an active partner of the law firm of Alexander & Green, counsel for the Mercantile Trust Company, counsel for John W. Young, counsel for the United States Shipbuilding Company, and acting from time to time as counsel for Nixon and Dresser as the Shipbuilding Syndicate. Col. McCook, as he has told me, became intensely interested in the proposed combination and did all he could to accomplish it. Young occupied a room adjacent to the offices of Alexander & Green, and Col. McCook and he appear to have worked in unison. Options on other shipbuilding companies were obtained and the plan was submitted to the banking house of H. W. Poor & Co., on Wall Street, which finally consented to become banker for an issue of bonds and a prospectus was issued. The companies which were then to be included in the deal were substantially the same as those which finally entered it. The prospectus was ready for issue on May 7, 1901, but on this day occurred what is known as the Northern Pacific panic, and the pamphlets were not distributed. Some say this was because of the panic; others that it was because no satisfactory report could be obtained of the annual earnings of the constituent companies. Whatever the reason, the project fell flat and Poor & Co. did not attempt to revive it. The promoters had all their work to do over again. For nearly a year they seem to have tried unsuccessfully to get other financial houses to assume the undertaking. Meanwhile, they succeeded in renewing some of their options.

On the 31st of March, 1902, the Trust Company of the Republic opened its doors for business at 346 Broadway. Its capital was $1,000,000, and its surplus $500,000. The Trust Company of the Republic proposed to deal with cotton growers in the South who are accustomed to borrowing money at New York legal rate of interest plus a bonus. It intended to lend money to the cotton people against crops stored in warehouses, at the legal rate of interest and without bonus, and to borrow money in the North against these crops and on other securities which it should accumulate. The opportunities for a large and lucrative business were bright and alluring. The new trust company had among its organizers and directors men whose names stood and today stand for strength and probity in the world of finance. Alexander Greig, President of the Security Warehouse Company of New York, with whose institution the new-born trust company immediately formed an affiliation, was one of the organizers.

As the head of this concern whose future seemed to promise so much, the directors selected Daniel LeRoy Dresser. Mr. Dresser was a merchant. He had been the President of the Merchants' Association of New York and had filled the positionnot incompetently, but his experience in the financial world was almost nil. However, he had valuable financial connections. By means of these connections he may have been expected to bring a large volume of business to the Trust Company of the Republic. It may be that Mr. Dresser was competent to handle the ordinary business of the Trust Company--indeed, no word of blame has ever been spoken of his management of the regular business--but when he entered into the industry of trust manufacturing, he succeeded only in inviting ruin both to his company and himself. He was bold with the boldness of ignorance, incautious in his dealings with other financial institutions and unable to deduce from the experience of others the natural outcome of his exceeding erratic methods and his inept handling of weighty matters.

The personal affairs of Mr. Dresser, however, are not within the scope of this paper, except so far as they indicate a lack of experience in the man who, above all others, except the actual dues ex machina, was responsible for the flotation of the United States Shipbuilding Company and the methods by which it was accomplished. It is fair to say that none except a tyro would have undertaken to finance matters of such vast importance by the methods he adopted, and that a man of wider experience and a larger measure of forethought would have dropped the whole thing before the borrowing period arrived, and would, indeed, have thrown it overboard upon the first indication that the entire burden of responsibility was to be placed upon his shoulders.

Nevertheless, here was a new trust company, anxious for business, with a man inexperienced in financial affairs at its head. In the same city were an eager promoter and a firm of lawyers, allied to a large trust company with powerful affiliations, who had for a long time used every effort to obtain the support of a financial institution in their joint project without success. Such a combination has its possibilities. They were sufficiently attractive for Mr. Young, the promoter, to seek an interview with Mr. Dresser. He succeeded, but not until it had been made apparent to Mr. Dresser that Col. John J. McCook was associated with him, as counsel or otherwise, in the plan which he had to propose. The promoter did not at first broach the subject of the United States Shipbuilding Company. Mr. Dresser was told of a syndicate of French bankers who desired to trade in American industrial securities and do their trading on this side of the Atlantic so that they might avoid the tax to which such transactions are subject when accomplished within the jurisdiction of the laws of France. There is evidence that it was represented to Mr. Dresser that the syndicate had been formed and was waiting only to make a connection with a responsible and reputable house in the United States. Profits derived from business which they should transact together were to be divided equally.

This seemed to Mr. Dresser to be an excellent opportunity for the Trust Company of the Republic, especially since the capital of the French institution was represented to be 20,000,000 francs, and before the former was a month old the preliminary arrangements for a working agreement had been completed and in writing. Before the binding agreements were attempted, the matter of the French banking house, of the existence of which no proof has ever been adduced, was dropped, and the plan for forming a shipbuilding combination was substituted. Exactly how this was accomplished it is almost impossible to determine. The truth is difficult to ascertain when the statements of the individuals most interested vary so widely. As a matter of fact, though, while negotiations concerning the French banking house were still uncompleted, Young sailed for Paris, leaving his affairs in the hands of his lawyers. This was on April 22d. At this time, according to the statements of both Col. McCook and Mr. Dresser, made to me personally, the Trust Company of the Republic still thought it was to co-operate with a French syndicate in the purchase and sale of American securities.

Mr. Young was absent on this trip to Paris about three weeks, leaving New York about April 22d. He returned to America about May 15th. During his brief stay in this country, before he took his second trip to Paris, copies of a prospectus for the consolidation of the shipbuilding plants under the name of the United States Shipbuilding Company appeared, without the name of any trust company as the banker, but with that of the Mercantile Trust Company as trustee of the

mortgage and transfer agent of the stocks, and Alexander & Green as counsel.

Mr. Dresser was asked to take up the matter of exploiting the United States Shipbuilding Company. A memorandum was shown to him, setting forth the profits which were to be derived from the successful performance of this work. Dresser agreed that the Trust Company of the Republic should act as banker, their name was inserted in the blank space left for this purpose and the prospectus was "confidentially" issued.

The original proposition was to issue $16,000,000 of bonds and $20,000,000 of stock, divided equally into common and preferred shares. This was before the Bethlehem Steel Company was considered.

A digest of the memorandum shows that it was proposed to dispose of $9,000,000 of bonds, $2,500,000 of preferred stock and $2,500,000 of common stock in order to realize $8,100,000 in cash. Of the cash and securities then remaining and in hand $6,400,000 in cash, $4,050,000 of bonds, $4,000,000 of preferred stock and $4,050,000 of common stock were to be paid to the owners of the properties to be acquired, leaving $1,700,000 cash, $2,950,000 in bonds, $3,750,000 of preferred stock and $2,750,000 in common stock. Of this $1,500,000 in cash and $1,500,000 of bonds were to be retained in the treasury of the proposed combination for working capital. This left $200,000 cash, $500,000 bonds, $3,750,000 preferred stock and $3,750,000 common stock--a grand total of $9,150,000, figuring the securities at par value--to go to the promoters. From it they were to defray the expenses of promotion. Before the constituent properties were purchased however, $400,000 cash was added to this profit by reducing the aggregate price to be paid for constituent companies to $6,000,000. The underwriting contract was with, and ran to, the Mercantile Trust Company.

The Trust Company of the Republic was asked to obtain $3,000,000 underwriting in the United States and the Mercantile Trust Company and Alexander & Green undertook to obtain $3,000,000 in Paris and $3,000,000 in London. In a letter written to the Trust Company of the Republic later John W. Young promised that its compensation should be $67,000 in cash, $250,000 in bonds, $700,000 in preference shares and $700,000 in common shares. This was large bait, and it was swallowed, hook, line and sinker.

From this time on Mr. Dresser, acting for himself and for his company, worked with Lewis Nixon in assisting the combination. When Young sailed for Paris he left his options, which were made to Lewis Nixon as trustee, and gave Mr. Nixon power of attorney over them. Young left also a tender of the companies on which he held options. The Trust Company of the Republic desired some further information than was contained in the prospectus, and there was sent to Mr. Dresser one W. T. Simpson, the accountant upon whose figures the prospectus was based . The accountant apparently succeeded in showing Mr. Dresser and his advisers that the companies to be taken in were in good condition and that to combine them was desirable. The Trust Company of the Republic then took up the favorable consideration of the tender of the companies which were to form the trust.

By the terms of the underwriting agreement, the $9,000,000 of bonds were to be underwritten at 90, and each underwriter was to receive as a bonus 25 per cent of his underwriting in each kind of stock. A public offering was to be made of the underwritten bonds at 97½, and the difference between this and the underwriting price

was to be shared pro rata among the underwriters, less expenses of advertising, etc.

Just at this time the agitation for a subsidy on American-built ships had reached its height and the measure before Congress seemed certain to succeed. English companies were casting something more than longing eyes in the direction of our shipyards in consequence, and were making substantial efforts to form such a combination as Young proposed. On the surface, with two-thirds of the bonds to be underwritten abroad, the plan seemed certain of success--and the profits to accrue to the principals in the undertaking were most enticing. The Trust Company of the Republic agreed to undertake that portion of the labor assigned to it and obtain $3,000,000 of underwriting. It did this the more willingly since word had been received from Young in Paris, that he was succeeding and that the underwriting allotted to the French capital would be completed in a few days.

The investing and speculating public had, seemingly, recovered tone and was at least supposed to be ready to again absorb securities of industrial combinations. It was not apparent at that time that the market was in the condition so excellently described by the most successful reorganizer the country, perhaps the world, has ever seen--glutted with undigested securities. Promoters and underwriters alike prophesied an easy sale of the bonds and a correspondingly easy reaping of profits.

The Trust Company of the Republic performed its share of the labor without difficulty, for the prospect of a large bonus of stock without the investment of a dollar appeals to underwriters. Indeed, so good did the proposition seem that $320,000 of bonds were paid for by the underwriters and withdrawn from the public offering, and $2,500,000 were represented to have been sold abroad.

When Young went to Paris, ostensibly perhaps, to attend to the matter of the French bank, but to obtain underwriting for the Shipbuilding Company, he found no difficulty in accomplishing his purpose so far as obtaining names was concerned. He had been in Paris before on promotion enterprises and had among his acquaintances a certain Baron P. Calvet-Rogniat. Him he enlisted in the undertaking, and when he returned to New York in the middle of May he brought a written contract in which the Baron agreed to obtain $3,500,000 of underwriting in France.

Rogniat's undertaking was as follows:

Paris, May 7, 1902

John W. Young, Esq.,
Dear Sir:

In consideration of the premises I for myself and as the representative of a group of financiers headed by Mr. Victor Schreyer, hereby undertake and agree to obtain the signatures of said group of substantial underwriters (who are good and who have agreed to underwrite the same) to the underwriting letter of the United States Shipbuilding Company, a copy of which is hereto attached, dated April 19, 1902, to the full amount of three million five hundred thousand dollars of the bonds of said company on or before May 21st properly verified, the same to be cabled to Messrs. Alexander & Green, 120 Broadway, New York City, on or before that date.

I also undertake and agree to procure either the withdrawal of said bonds under the terms of said underwriting letter, or the

public issue of said bonds under the terms of said letter through either the Franco-Swiss Bank of Paris or other equally substantial bank, simultaneously with the public issue of the said company's goods, in America, it being understood in accordance with clause one of said underwriting letter that this agreement shall not be binding upon the undersigned unless the entire amount of 9,000,000 of bonds shall have been underwritten.

Yours truly,
P. CALVET-ROGNIAT.

Rogniat appears to have obtained this underwriting and more. It was easy for him to do this because what seemed to be required was a list of names signed to the underwriting agreement. The element of responsibility does not seem to have been so closely inquired into.

Representations were made to prospective underwriters there that the American public was simply wild with desire to buy the securities of industrial combinations, and that all that was necessary was a list of names with amounts set opposite to each which should aggregate $3,000,000; that the securities would find a ready market here, and that the issue of $9,000,000 would be oversubscribed. This, it was explained, would leave the underwriters in the enviableposition of taking profits without investing a single franc. This is usually, of course, the ideal of an underwriter, but it is customary, even in Wall Street, for an underwriting to be able to meet his obligation.

So far as can be ascertained few substantial Parisians placed their names on the agreement. Strenuous efforts which were made later to compel these underwriters to pay their obligations failed absolutely, except that the Baron Rogniat did contribute $25,000, for the recovery of which amount he has brought suit against the Mercantile Trust Company. A total of $4,250,000 was underwritten in this manner in the French capital and a list of the names obtained was forwarded.

Mr. Dresser was advised that because of the coronation preparations which were being made in London it had been found impossible to conclude arrangements for obtaining the $3,000,000 of underwriting which had been guaranteed from the English capital. Mr. Dresser was asked if he would undertake to obtain here an additional $1,750,000. The list sent by Rogniat indicated that Paris would take $4,250,000, which left only $1,750,000 of the foreign underwriting to be secured. Mr. Dresser agreed to perform this extra work. The burden was being shifted gradually to the shoulders of the Trust Company of the Republic. A more experienced man would at this point have obtained this or washed his hands of the entire matter. A more astute man would have taken alarm at the too evident unwillingness of the other trust company to publicly assume the responsibility. The proposition to assign the underwriting to the Trust Company of the Republic was significant.

Under these conditions the bonds of the United States Shipbuilding Company were offered to the public on June 14, 1902. On that date a prospectus was published in the public print which stated what was not true. The question whether this prospectus was authorized by the Trust Company of the Republic or by the Mercantile Trust Company or by both is before the court.

The prospectus stated, among other things, that the United States Shipbuilding Company had been organized under the laws of the State of New Jersey, and mentioned as directors a number of responsible

men. It goes without saying that these gentlemen were not directors, because the company had not yet been fully organized. Some of them say that they were not consulted about the use of their names, and only four of them ever served as directors when the company was organized some months later. The prospectus went on to say that Alexander & Green, counsel for the new company, certified as to the validity of the organization and of the securities issued and the title of the company to the property acquired. It stated that the plants were earning $2,250,000 a year and had abundant facilities for additional work and increased earnings. On June 18th the books were opened for subscriptions in 12 cities in this country and in Paris, and the fishermen sat back and waited for the public to take the bait.

The response was not only discouraging; it should have been fatal. The public sent subscriptions for only $490,000 of the bonds. This was again a period where the Trust Company of the Republic should have thrown the undertaking overboard and charged the expense it had incurred to profit and loss. The public did not rise to it, the underwriters did not want it or they would have taken their bonds before they were offered at public sale, and the whole thing was flattening out.

The promoters turned to Bethlehem (not in the scriptural sense) for salvation.

On June 12, 13 and 14, 1902, Mr. Dresser and Mr. Nixon discussed with Charles M. Schwab, President of the United States Steel Corporation, the advisability of acquiring the Bethlehem Steel Company for the Shipbuilding Company, and submitted to him financial statements of the Shipbuilding plants, their resources, liabilities and earnings. The Bethlehem Steel Company was prosperous and remunerative and, besides, would place the United States Shipbuilding Company, if acquired by the combination, in the enviable position of being able to build armored vessels and thus compete for government work.

Some idea of the value and importance of this company can be learned from the earning capacity of the property. At the time of its transfer to the Shipbuilding Company, it was earning at the rate of $1,500,000 a year, and is now earning, I am informed, at the rate of $3,000,000 a year. The interest charges on the underlying bonds make the only fixed charges of $557,500, which would leave substantially, at the present rate of earning, for distribution upon the securities issued on account of that property 5 per cent on the $10,000,000 of bonds, 6 per cent on the $10,000,000 of preferred stock and 14 per cent on the $10,000,000 of common stock.

Mr. Schwab asked for the Bethlehem Steel Company $9,000,000 in cash, besides a certain amount of securities. The cash was, of course, out of the question. The promoters had peddled all the securities for which they could find a market and did not see their way clear to sell outright bonds against the Bethlehem Steel Company, which was the only way in which they could raise money to pay the demand of Mr. Schwab. They proposed therefore to pay for the Bethlehem Steel Company with securities issued against that plant itself. Mr. Schwab told them that Mr. J. P. Morgan, who was then in Europe, would have to be consulted, because J. P. Morgan & Company, as managers of another syndicate, held the stock of the Bethlehem Company, and were entitled to participation in any profit realized from such a sale. Mr. Morgan was communicated with by cable and an answer was received. In the afternoon of June 14, 1902, Mr. Nixon and Mr. Dresser closed the negotiations for taking the Bethlehem Steel Company.

Nixon and Dresser agreed that Mr. Schwab should receive $10,000,000 collateral mortgage bonds and $10,000,000 of each kind of stock, $30,000,000 in all at par, for the capital stock of the Bethlehem Steel Company. Later, the common stock was increased by an additional $5,000,000, which, it seems, was to be used for promotion purposes. By this method it was proposed to increase the capitalization of the company, advertised as $20,000,000 with $16,000,000 bonded indebtedness, to $45,000,000 stock and $26,000,000 bonded indebtedness.

After the negotiations for the Bethlehem property were concluded, Mr. Schwab called in his counsel, Mr. Max Pam, to prepare the necessary contracts. This was Mr. Pam's first connection with the matter.

On June 17, three days after the prospectus was published, the United States Shipbuilding Company was incorporated in New Jersey by an officer and two employes of the corporation Trust Company for $3,000. These men acted as directors also, taking their instructions from the promoters. In July the capital of the company was increased to the amount I have already mentioned, a dummy board of directors having been furnished for this purpose.

On July 2, Mr. Nixon and Mr. Dresser went to Mr. Schwab's office to sign the formal agreement under which they were to take over the Bethlehem Steel Company. They contracted to pay to J. P. Morgan & Company, as syndicate managers, $7,246,871.48 in cash and $2,500,000 of each kind of stock of the Shipbuilding Company for the 299,910 shares of the Bethlehem Company which were held by J. P. Morgan & Company as syndicate managers. This was the entire issue of Bethlehem stock, with the exception of ninety shares. The par value of each share was $50. In order to get the money with which to pay J. P. Morgan & Company Mr. Nixon and Mr. Dresser signed with Mr. Schwab an agreement which assured to them this cash requirement.

Under this agreement Mr. Schwab contracted to furnish the cash necessary to acquire the stock of the Bethlehem Steel Company and to accept in return $10,000,000, par value, 5 per cent, twenty years collateral gold bonds, and $7,500,000 of each kind of stock of the United States Shipbuilding Company. The mortgage on which the bonds were to be issued was to be a second mortgage/lien upon the properties of the Shipbuilding Company and to have a voting power equal to the same amount of stock, although the first mortgage on the constituent companies was not to cover the Bethlehem Steel Company. The shares of the Bethlehem Steel Company, acquired thus with Mr. Schwab's money, were to be deposited with the New York Security and Trust Company as security for the mortgage; the Shipbuilding Company was required to guarantee a dividend of 6 per cent on the capital stock of the Bethlehem Company, to provide the Bethlehem Company with work sufficient to earn this dividend, or to advance the money thereof, and to see that the Bethlehem Company should always have the $4,000,000 working capital which it then claimed to have.

It was also agreed that the holders of the collateral bonds in the absence of any default should elect a full minority of directors of the Bethlehem Steel Company. The form and provisions of the bonds to be issued under this agreement were to be satisfactory to Mr. Schwab and his counsel, and the deal was not to be concluded until the other constituent companies had been duly acquired and paid for.

Mr. Schwab and Mr. Pam have been criticised severely for making the terms of this contract stringent. I asked Mr. Pam recently why Messrs. Nixon and Dresser agreed to the terms of that contract, and he replied that the terms of the contract were not unreasonable, that they were intended to protect Mr. Schwab against any untoward contigencies; that the agreement was submitted by Messrs.Nixon and Dresser to their counsel and was fully discussed and passed by him before being signed by them; that the terms of the agreement were assented to and the contract signed after conference and negotiation between himself and Messrs. Nixon and Dresser and Messrs. Alexander & Green, who, in this matter, at least, were acting as Nixon and Dresser's counsel.

Mr. Alexander, while abroad, had gone to Paris to see if any money could be collected from the underwriters there. He found them averse to paying anything. In the first place, they said, they had been induced to underwrite by being told that payment would never be expected; in the second place, after the pitiful failure of the public offering, a cable was sent to Paris saying that the public issue was a success. This the Paris underwriters interpreted as meaning that the entire $9,000,000 of bonds had been taken by the public and that nothing remained for them to do except to take their profit. They refused to accept Mr. Alexander's explanation that it was the custom in this country to call an issue a success, no matter how badly it had failed, and to peddle the bonds afterwards. The best Mr. Alexander was able to accomplish was to get the Frenchmen to give their notes for the amounts they had underwritten. These notes were to mature on October 6. That the French underwriting was nil was not, however, admitted by the contracting parties. It was still carried as a good asset and counted in as part of the underwriting.

Nevertheless, Mr. Alexander seems to have sent written and cabled assurances of the bona fides of the French underwriting. His opinion seemed to be that it would be paid and that it was delayed only on account of details. He represented himself to the Paris banking community as counsel for the Mercantile Trust Company in this matter and instructed them about the transfer of funds to New York when payments should be made, and also in regard to other details of the transaction, as their counsel. Assurances were received from Paris, and from time to time reiterated, that the money from the French underwriters would be forthcoming.

On the 23d day of July, 1902, by cable the French underwriting was called.

The calls were made by cable to avoid legal complications under French laws. The following cable affords an example of all:

"July 23, 1902.

"Odero,
C/o Panta (the cable address for Rogniat), Paris.
Have allotted you $8,000 bonds of the Shipbuilding underwriting. Pay Morgan & Harjes twenty-five per cent on allotment July twenty-fifth. Upon payment we will issue negotiable receipt in New York to your order.

MERCANTILE TRUST CO."

The American underwriters had responded promptly to the call, and an inquiry from New York as to why Paris did not pay brought the following:

"Paris, July 25th, 1902.

"McCook, N. Y.

All I hear indicates general response. Short notice creates slight delay. Appreciate money must be in New York before August. Underwriters contemplate simultaneous payment. Have payments been made New York.

(Signed) Beatty."

(McCook was the cable address for Alexander & Green, and Beatty was the cable address of C.B. Alexander.)

On the 5th of August, 1902, matters were approaching a crisis and the following was sent:

"New York, August 5, 1902.

"Oppenheim, Young and Mayer,
C/o Trebor, Paris.

Can you not give us an exact statement of the present conditions of payments by underwriters each for twenty-five per cent due July twenty-fifth and August first respectively, and when cash remittances will be actually paid. We must know on account of commitments here, and so far have nothing except promises. Where is the hitch and why the continued delay after everything so far as we can gather from your cables, is settled.

Republicus McCook Nixon."

Finally, on the 7th, the following cable was sent to Young:

"New York, August 7, 1902.

"Young,
C/o Trebor, Paris.

We are getting tired of promises to pay tomorrow. We must make our payments here and must have French money to do it with.

Republicus."

The following cables further explain the situation:

"New York, August 8, 1902.

"Calvet Rogniat,
C/o Trebor, Paris.

Monday last day for closing Bethlehem. All other plants must be paid for before closing this transaction. It is absolutely essential to have your money in New York Saturday.

Republicus."

"New York, August 11, 1902.

"Calvet Rogniat,
C/o Trebor, Paris.

No payments received to-day from French underwriters. Please cable immediately when money is to be in New York.

Republicus."

"Paris, August 12, 1902.

"Republicus, N.Y.

Rogniats Russian returns delayed yesterday; learn part arrived; he and others pay today; Schreyer and all seem now ready to pay. Know nothing of second call. Have wired Alexander to come here.

Our persuasion and his iron hand in velvet glove of course will bring desired results.

Young."

And finally we have this significant suggestion by cable:

"St. Moritz, August 13, 1902.

"McCook, (Alexander & Green, N.Y.)

Suggest Mercantile assign to Shipbuilding Company call, who can sue or to Republicus with consent of Shipbuilding Co.

Alexander."

As late as September 8th the theory was still current that there would be results from the French underwriting.

About the 6th of October, 1902, Mr. Dresser arrived at Paris and within a few days after his arrival cabled to the Trust Company of the Republic that the French underwriting was valueless. Mr. Dresser's opinion of the French underwriting was expressed in much stronger language than this.

The relation of the Mercantile Trust Company of New York must not be overlooked in this transaction. It was the party of the first part to the underwriting agreements, and the trustee of the bond issue. It was, as I have already stated, the first financial institution having announced public relations with the Shipbuilding undertaking.

The prospectus showed that there would be an issue of $16,000,000 of bonds secured by a first mortgage upon the Shipbuilding Company's plants, of which bonds and mortgage the Mercantile Trust Company acted as trustee, and the bonds were not valid and were not subject to issue or use until each bond was properly certified by the trustee, and were issuable only on its counter signature as trustee.

On June 24, 1902, John W. Young undertook to transfer and sell to the Shipbuilding Company these various shipbuilding and other properties, with a certain amount of cash, and his payment was to come from the issue of $16,000,000 of first mortgage bonds, of which $1,500,000 were to remain in the treasury.

The Shipbuilding Company did not acquire title to the shipbuilding plants until the 11th of August, and up to that time no bonds were apparently deliverable on any account whatever. Any issue of the bonds prior to that time seems strange to the uninitiated.

That the Mercantile Trust Company had legal title to the bonds themselves, or had any interest therein, does not appear to be the fact. The only apparent interest on the part of this trust company was its compensation as trustee.

On the 11th day of August, when the Bethlehem properties were to be turned over, the promoters of the Shipbuilding enterprise were facing a crisis. Under the contract for the sale of the Bethlehem property it was provided that the original properties of the Shipbuilding Company should not only be acquired, but the title vested in the Shipbuilding Company, and this required the payment of $6,000,000, besides the possession of a cash working capital of $1,500,000.

The provisions of the agreement showing the caution exercised in behalf of Mr. Schwab, to assure the full compliance with these conditions and to assure the good faith of the transactions before the Bethlehem was turned over, are as follows:

"At the time of the said purchase of said shares of stock of the Bethlehem Steel Company by said Nixon and Dresser and the sale to said Schwab of the bonds, preferred stock and common stock to be issued by said Shipbuilding Company, as herein provided for, said

Shipbuilding Company shall have duly purchased and become possessed of the property and assets or the capital stock or both of said 'Subsidiary Companies.'

"Said Nixon and Dresser shall furnish the certificates of Messrs. Alexander & Green, Counsel for said Shipbuilding Company, and the other parties financially in interest in such form as shall be satisfactory to said Schwab, of the validity of the organization of the said Shipbuilding Company, of the acquisition by it of the properties, plants and assets or capital stock or both of said 'Subsidiary Companies,' of the acquisition by it of said stock of the said Bethlehem Steel Company, of the issuance of full paid, non-assessable shares of preferred stock and common stock of the Shipbuilding Company to be delivered to said Schwab under this agreement, and of the validity thereof, and of the authorization and issue of the stocks and bonds of the Shipbuilding Company, together with satisfactory evidence of the consent and authority of all parties in interest, for the issue of the said stocks and bonds of said Shipbuilding Company, as herein provided for."

To summarize, it was insisted in behalf of Mr. Schwab that the Bethlehem Company should not come into the combination until the other properties had been acquired and paid for, the titles vested in the Shipbuilding Company and the considerations for the issuance of the various securities properly received.

The necessary certificate of Alexander & Green was furnished to both J. P. Morgan & Co. and Mr.Schwab, as shown by the evidence taken before Mr. Oliphant, United States Commissioner, in the Shipbuilding hearing.

A cable to Young, in Paris, on August 8th, said:

"Under our contract to purchase Bethlehem, which must be consummated Monday, we have to have all other plants fully paid for and transferred to Shipbuilding Company first. This means all cash must be in hand Saturday, entirely irrespective of date of option. There is a serious danger in Bethlehem matter as they will give no extension of time. Republicus."

How, then, was the money to be raised? It was suggested that Mr. Dresser take Shipbuilding bonds which it would seem were in the possession of the Mercantile Trust Company, presumably as trustee, and obtain loans on them from various institutions.

Dresser and Nixon got some loans, but they were unable to get enough. Therefore, Dresser arranged with several different institutions for deposits of the Trust Company of the Republic's funds, and then they borrowed the amount of this money individually, placing with the loaning institution an amount of Shipbuilding bonds, double the amount borrowed, giving their joint notes and the guaranty of the Trust Company of the Republic signed by D. LeRoy Dresser, President.

Some of these loans were on the books of the Trust Company of the Republic, but new loans were not at first all put upon the books of the Trust Company of the Republic as an indebtedness of the Trust Company, but were entered as contingent liabilities, and some were carried as assets.

In one instance, five hundred thousand dollars were deposited in a trust company by Mr. Dresser as an interest-bearing deposit,

a credit to the Trust Company of the Republic. Five hundred thousand dollars were borrowed from this same trust company by Mr. Dresser uppn $1,000,000 of Shipbuilding bonds furnished by the Mercantile Trust Company, accompanied by the joint note of Mr. Nixon and Mr. Dresser and a guaranty executed by Mr. Dresser in the name of the Trust Company of the Republic. All of this was done, according to the testimony, in the branch office of the Trust Company of the Republic at 71 William Street, N. Y. City, and the minutes of the Trust Company of the Republic do not show that the transactions were at the time done with the knowledge of the Board of Directors.

Mr. Nixon and Mr. Dresser than took the check of the other trust company, to the order of Nixon and Dresser, and deposited it in the Trust Company of the Republic to the credit of the loans of Nixon and Dresser.

There was a failure to observe proper banking methods.

The Knickerbocker Trust Company seems to have declined to loan on Dresser's and Nixon's notes with the collateral of the Shipbuilding bonds, and required additional collateral. It therefore obtained the following assignment:

"Know all Men by these Presents, that the Mercantile Trust Company, a corporation of New York, hereby releases to the United States Shipbuilding Company (a corporation of New Jersey), its successors or assigns, all the right, title and interest of said Mercantile Trust Company in and to certain underwriting agreements relative to the First Mortgage Five Per Cent Sinking Fund Gold Bonds of the said Shipbuilding Company, hereto annexed, and respectively executed by the following named Subscribers, for the amount of bonds set opposite their names, to-wit:"

(Here follow the names of underwriters and underwritings amounting to $1,400,000.)

"The Mercantile Trust Company hereby certifies to the said United States Shipbuilding Company and to each and every person who may succeed to the title and interest of said Shipbuilding Company in and to any of said underwriting agreements that the entire amount of nine million dollars ($9,000,000) of bonds was underwritten as provided in Condition No. 1, in said agreements.

Dated August 11, 1902.

Mercantile Trust Company,
By A. W. Krech,
Vice President."

"In the presence of
W. W. Green."

The condition No. 1 referred to in the said certificate refers to the provision of the underwriting agreement that no underwriter shall be called upon to pay until the entire $9,000,000 is subscribed.

This assignment was accompanied by a transfer by the Shipbuilding Company, signed by James Duane Livingston, Second Vice-President, to Lewis Nixon and D. LeRoy Dresser, which contained this recital:

"Lewis Nixon and D. LeRoy Dresser are about to borrow from Knickerbocker Trust Company the sum of seven hundred thousand

dollars ($700,000), and to assign as collateral security therefor the above described underwriting agreements to the extent of the unpaid liability of the subscribers thereon, together with the First Mortgage Five Per Cent Sinking Fund Gold Bonds of the Shipbuilding Company to the amount in par value of $1,600,000 and Preferred stock of the Shipbuilding Company to the amount of 4,000 shares and Common stock of the Shipbuilding Company to the amount of 4,000 shares."

Upon these two documents was endorsed a second assignment in the following language:

"For value received we assign, transfer and set over to the Knickerbocker Trust Company all our right, title and interest in and to the foregoing instrument, and in the underwriting agreements therein mentioned.

Dated August 11, 1902.

Daniel LeRoy Dresser,
Lewis Nixon."

"In the presence of
Brainard Tolles."

In view of the French situation the effect of the certificate of the Mercantile Trust Company that the entire $9,000,000 had been underwritten is not quite clear.

A psychological study of Mr. Dresser's mental condition at this time would be interesting if it would not be pitiful. He was the head of a trust company which had been doing business for less than six months. Its opportunities at the start were almost boundless, and its stock, issued at 150, was quoted around 370. A high place in the financial world was open to Mr. Dresser himself as the president of this company, but because of his ambition to make money in large sums, regarding thousands as too small to be considered and thinking only in millions, he had not only thrown away his opportunity, but was in danger of wrecking his company. Personally he had no extensive credit upon which to draw if he had desired to assume the responsibility for the large sum necessary to purchase the constituent companies. He had reached the end of his resources. He had exhausted the resources of the Trust Company of the Republic. Both were in danger, and he knew it. The responsibility had been skillfully shifted upon his shoulders. No help seemed forthcoming from the originators of the undertaking. The promises of the promoters as to French financial returns were becoming shadowy. In this predicament he sought Mr. Schwab's counsel, Mr. Schwab being in Europe at the time. Mr. Pam took Mr. Dresser over to the office of J. P. Morgan & Co. and introduced him to Mr. Perkins.

Mr. Dresser requested a loan of $2,500,000, but Mr. Perkins said he could not make loans on Shipbuilding securities. Mr. Dresser said that he and his associates were expecting to receive remittances in a week or ten days from the French underwriting and would need the assistance only that long. The evidence is that Mr. Perkins was told the proceeds of the French underwriting would not long be delayed. Mr. Dresser called again the next day and told Mr. Perkins that several financial institutions would be willing to assist them if they could have the additional funds, and again requested a loan.

Mr. Perkins was unwilling to make a loan, but he did finally say that he would deposit $2,100,000 in any three responsible trust

companies Mr. Dresser might name for ten days or two weeks.

Mr. Dresser mentioned the Knickerbocker Trust Company, the Trust Company of the Republic and the Manhattan Trust Company.

The Manhattan Trust Company did not accept a deposit. The other two companies did receive $1,400,000, issuing their certificates of deposit to J. P. Morgan & Co., and lent this amount to Mr. Nixon and Mr. Dresser.

Mr. Perkins introduced Mr. Dresser to the New York Security & Trust Company, which, it is said, made a loan to Dresser and Nixon of $350,000, making the total assistance secured in that way $1,750,000

The $1,750,000 thus borrowed, while it was a great help, was not sufficient to place the promoters in a position to buy the properties for which they held options. They were still short of the necessary cash requirements, But the Trust Company of the Republic had more than $4,000,000 in deposits.

Methods similar to these were taken with other institutions, until, in the joint names of Mr. Nixon and Mr. Dresser, secured by the guaranty of the Trust Company of the Republic issued by Mr. Dresser, and the Shipbuilding collateral furnished by the Mercantile Trust Company, some millions were raised, sufficient to draw the checks to the vendors, which checks aggregated $6,000,000.

To lend this to its own president would be an irregularity too flagrant not to attract undesired attention at some time or other, so the Trust Company of the Republic made loans to Mr. Nixon, accepting therefor his note secured by bonds and stock of the Shipbuilding Company, whose entire assets consisted of Young's offer to sell the Shipbuilding plants, which it could not take up for lack of funds.

The Trust Company of the Republic had received from underwriters and subscribers $2,327,812.50, of which it had contributed $250,000 of its own money. It had lent directly to Mr. Nixon and Mr. Dresser, or supported their notes by its guaranties, $3,672,187.50.

Under these conditions the fateful day for paying for the properties arrived. The Trust Company of the Republic prepared twenty-four checks, aggregating $6,000,000, fifteen of which were made out to the order of Lewis Nixon, and the latter, as holder of the options through Young's power of attorney, delivered the checks to Col. McCook and Mr. Young for the owners of the constituent companies. Besides this cash, the vendors, of whom Mr. Nixon was one, were supposed to receive $4,050,000 in bonds and $4,000,000 in each kind of stock.

The great Shipbuilding Company was now an accomplished fact with the exception of taking over the Bethlehem.

This latter transaction, which was performed on August 12th, though of vast importance, was very simple. Mr. Nixon and Mr. Dresser met the various parties in interest in the office of J.P. Morgan & Co., and there received the stock of the Bethlehem Steel Company, paying for it with Mr. Schwab's check for $7,246,871.48 and passing over $10,000,000 collateral mortgage bonds, $10,000,000 of preferred stock and $10,000,000 of common stock, of which $2,500,000 of each kind of stock was delivered to J. P. Morgan & Co. as syndicate

managers. It remained only for the new holders of the Bethlehem stock to deposit it with the New York Security and Trust Company as security for the collateral mortgage. This they did without delay.

It is not my intention to follow the fortunes of the United States Shipbuilding Company to their conclusion. It is clear, however, from the disclosure of the facts, that with the exception of the Bethlehem Steel Company, the Union Works and the Hyde Windlass Company, the constituent companies were indebted far beyond their ability to pay, and the new trust was without the earning capacity to meet the heavy fixed charges fastened upon it by the promoters' issue of $16,000,000 of bonds against these properties. The subsequent failure and fall of the company was inevitable, no matter who was in charge of its affairs or how efficient its management.

I have devoted many weeks to the examination of the evidence, documents and facts in connection with the entire matter, and have carefully and thoroughly informed myself from all sources of information with reference thereto, and find that neither Mr. Schwab nor Mr. Pam appear anywhere to have had any connection with the promotion, organization or financing of the Shipbuilding enterprise or the various transactions in connection therewith.

Whether in view of this, the criticism of Mr. Schwab in securing for himself so large a consideration for the Bethlehem Steel Company stock is justified, considering that he is the only one who received no cash for his property, but took his entire pay in securities is not for me to say, nor is it my province to comment on the criticism and complaint made against his counsel, Mr. Pam, for his faithfulness in protecting his client's interests in the preparation of the contract and mortgage, the terms of which have been regarded by some as tight and as exacting too much security. It was Mr. Pam's effort to safeguard and protect his client's interests against any unforeseen contingencies.

It is well, however, to continue with the Trust Company of the Republic until the final effect of its operations has been shown. The parties in interest must have fairly groaned with relief when the properties were paid for, although the methods by which they accomplished this reminds one rather of the shiftless Micawber than of any other person or thing in fiction or in history.

It must also be borne in mind that this transaction was all completed in a short space of time and during the months of July and August of the summer of 1902, when there were few if any meetings of the Board of Directors of the Trust Company of the Republic. In fact, it is evident that Mr. Dresser, as President of the Trust Company of the Republic, treated this trust company as if it were the firm of Dresser & Company and he was at its head. The transactions were not entered upon the minute-book of either the Executive Committee or the Board of Directors. Dresser and Nixon seemed to act upon Micawber's theory that if the money was raised and the properties were paid for it was of no importance what obligations were undertaken to secure the money. Proceeds of the French underwriting were to cure all ills and to cover all sins of omission and commission.

The troubles of the unfortunate Trust Company of the Republic were just beginning. The French underwriting produced not a dollar. The mouse, as a result of the mountain's labor, was, compared with the

result of the French underwriting, magnificent, but not sufficient. Dresser's ambition to organize a gigantic trust had been satisfied, but in the process the capital, surplus and deposits of the Trust Company of the Republic had been nearly wiped out and it was in an exceedingly precarious position. Only immense success on the part of the creature it had made could save it from the fate of Frankenstein. It had gambled on the result of the French underwriting and had lost. Although the great Shipbuilding Company had been launched and the required $1,500,000 of working capital credited to the United States Shipbuilding Company on the books of the Trust Company of the Republic as of August 12th, the funds therefor were lacking to meet its drafts. It became necessary to provide that amount. Armed with guaranties signed by Dresser in the name of the Trust Company of the Republic and a vast amount of Shipbuilding securities, Mr Nixon and Mr. Dresser borrowed, on August 30 and September 4 and 5, 1902, $1,500,000 from New York banks on their notes, secured in what had now become the usual manner.

The returns from the American underwriters and subscribers were applied to the reduction of the obligations of Mr. Nixon and Mr. Dresser. They brought the total in which they were indebted to the Trust Company of the Republic down to $3,279,909, to repay which they had nothing more substantial in sight than the French underwriting. This amount was afterwards reduced to $982,334.10.

At this point the bank examiner visited the Trust Company of the Republic. Its difficulties were not a matter of general knowledge, and it was esteemed a most prosperous institution. Its warehouse business in the South was growing at a phenomenal rate, the newspapers were filled with tales of its progress and its brilliant prospects in an almost virgin field. But when the state bank examiner finished his inspection the world was informed of the almost inextricable tangle it had got into through its connection with the Shipbuilding Trust, and its stock dropped to below par.

At this critical juncture a syndicate, which became known as the Sheldon Syndicate, was formed to take over the financial obligations of the Trust Company of the Republic, accepting in payment therefor securities of the Shipbuilding Trust. The Syndicate did take over these obligations and thus relieved in part the situation. Even then, had the Shipbuilding Company been established upon a sound basis, or had it even acquired properties which, exclusive of the Bethlehem, were sound and self-supporting, the Trust Company of the Republic would have won its way clear financially. But since the Shipbuilding Company was itself insolvent and a failure, it was not possible for the Trust Company of the Republic to realize on the securities which it held of the combination and thus replace the large amount in which it was involved. Its reputation, too, had been sacrificed.

It was reorganized and is today only a memory, and its history only a contention in the courts.

Do not for one moment assume that I have covered the whole question of the relation of the trust company to the industrial combination, and not even the whole question as to the relation of these two trust companies to the Shipbuilding Corporation. On the contrary, I have carefully avoided discussion of certain topics which may be the subject of litigation, and I have touched only so far as was necessary to fill out the lines of my view of the situation upon matters per-

taining thereto which are in doubt and which may be the subject of litigation.

The tendency of financial institutions--known in our State as "moneyed corporations"--is to affiliate too closely with industrial propositions, the ultimate outcome of which cannot be adequately determined from the showings made by promoters and others interested in their flotation.

There is a side of the picture which is less unpleasant than the side which I have turned to you. It is that the lesson which has been taught by the organization of the Shipbuilding Company had a wholesome effect upon Wall Street and other financial institutions. It is, too, because the present Superintendent of Banks in the State of New York ably supervised the adjustment of the intricate details, so far as his jurisdiction was concerned, that no financial panic resulted from a disclosure of the condition into which the Trust Company of the Republic had been led by its president.

I have no time to draw a parallel, but I think that those who are familiar with the history of similar undertakings in England and Scotland will admit that they show a more dangerous affiliation in those countries between financial institutions and industrial promotions. Across the water many men of high financial position acted as directors of flotations which were similar to this one, but which had really a less stable foundation. Many financial institutions not only fathered industrial propositions which failed to turn out as expected, but they endorsed them. The result was that in England, after a collapse, financial institution after financial institution closed its doors and a panic resulted.

From the standpoint of a single individual, I believe that I have portrayed to you the final example of an undertaking of the kind which I have been describing. Today, as a consequence of the lesson which has been learned through the false establishment of the United States Shipbuilding Company, our financial leaders and our financial institutions are gradually withdrawing from affiliations with industrial combinations, and each one is assuming its true position.

You will agree with me that the institution and the industrial combination are of value, each in its place, but a close partnership between the two is dangerous, inasmuch as the financial institution and the industrial combination must necessarily stand upon a different footing in their relations to the public. The salve in the situation is that the general public did not become a participator in the flotation of which I have been speaking, and did not invest largely in the securities of the Shipbuilding Company.

The result has been unfortunate for those who did become investors, but the heaviest loss fell upon those who were in a better financial position to stand it, namely, the underwriters, who entered for profit and who expected large returns with but little responsibility.

Even in the case of the Trust Company of the Republic it is a subject for congratulation that through the wisest subsequent management which undertook its reorganization, its integrity has been maintained, its financial credit has been sustained and as a consequence of the assistance rendered by the men who formed what is known

as the Sheldon Syndicate, who can well afford the loss, it is in a position where it can continue business and place itself before both the public and the financial world as an institution of probity and integrity.

I apprehend that you would like to hear a narration of the entanglements of Governor Odell of the State of New York, Mr. J. Pierpont Morgan and his form, the banking house of Harris, Gates & Co., and many others who became collaterally interested; but it is impossible for me to enter upon these various subjects.

I leave therefore this matter with you, having attempted to tell you briefly and succinctly and yet as correctly as I have been able and without bias, the true history of the organization of the United States Shipbuilding Company.

Reading No. 27

BAKERY COMBINES AND PROFITS
Letter from the Chairman of the Federal Trade Commission
69 Congress, Second Session, Senate Document 212.

Federal Trade Commission
Washington, February 11, 1927.

To the President of the Senate.

SIR: Under a resolution of the United States Senate (Senate Resolution No. 163, 68th Cong., 1st sess., approved February 16, 1924) the commission was directed to investigate the production, distribution, transportation, and sale of flour and bread, showing costs, prices, and profits at each stage of the process of production and distribution from the time the wheat leaves the farm until the bread is delivered to the consumer; the extent and methods of price fixing, price maintenance, and price discrimination, the developments in the direction of monopoly and concentration of control in the milling and baking industries, and all evidence indicating the existence of agreements, conspiracies, or combinations in restraint of trade. The terms of this resolution, therefore, involved inquiry not only into the bread-baking industry but also into the wheat-flour industry and the grain trade.

This preliminary report considers certain of the more important phases of the inquiry in so far as the bread-baking industry is concerned, including (1) the consolidation movement in the industry; (2) the development of the largest baking companies, including Ward, General, and Continental; (3) the extent to which the formation of the Continental affected competition; (4) the close interrelation of these large consolidations and the formation and judicial dissolution of the supercombination, the Ward Food Products Corporation; (5) the rates of return on investment and costs and profits per pound for wholesale bakers; (6) the relation of consolidation to costs of production and distribution; and (7) a comparison of the costs of producing and selling bread for wholesale, house-to-house, and chain store bakers.

A preliminary report summarizing profits of flour millers, and giving information relating to their efforts to restrict competition has already been made.

Competitive conditions in the baking industry, the marketing of flour and bread, analysis of costs and profits in the bread and flour industries, the expenses of grain marketing, and the apportionment of the consumer's dollar spent for bread between the costs and profits of the successive agencies of production, manufacture and distribution, are the principal additional matters reserved for the final report.

Consolidation Movement

The consolidation movement in the bread-baking industry began in 1907 with the combination of seven St. Louis plants to form the American Bakery Co. and this consolidation was followed shortly after by several others. In 1911 the General Baking Co. embracing 21

plants was organized and in 1912 the Ward Baking Co. with 8 bakeries. These were especially important. Numerous other consolidations followed in succeeding years: Cushman's Sons (Inc.) (7 plants) in 1914: the New England Bakery Co. (6 plants) in 1915; Flour State Baking Co. in 1916; Massachusetts Baking Co. (8 plants) in 1917; Tristate Baking Co. (4 plants) in 1919; Campbell Baking Co. and Gordon Co. in 1920; Nafziger Baking Co. in 1921; Standard Bakeries Corporation (8 plants) in 1923; Southern Baking Co. in 1924.

In 1921 a movement toward the reconsolidation of various earlier combinations began with the formation of the United Bakeries Corporation, which combined the Campbell and Shults companies, and a number of other plants. The organization of the United in 1921 marked the entry of the holding company as an important factor in bakery consolidation. It was followed by the formation of what may be termed the big four of the bakery industry, the Ward, General, Continental, and Purity companies in the period 1923 to 1925. Moreover, of these four, all but the Purity were closely associated.

Ward, General, and Continental

The Ward Baking Corporation, a holding company, was organized by William B. Ward, the chairman of the board of directors of the United Bakeries Corporation, in 1923, following a contest for the control of the Ward Baking Co. between him and George S. Ward, the president of the latter company. The new corporation then exchanged its stock for that of the old company. The latter had grown considerably since its formation some years previously and by 1916 was operating 14 bakeries. In 1926 its active plants numbered 18.

The General Baking Corporation was organized in October, 1925, as a holding company for the old General Baking Co., the organization of which has been previously referred to, and other baking companies. This new corporation exchanged its stock for that of the old company. On November 23, 1925, the General Baking Corporation purchased the capital stock of the Smith Great Western Corporation which had consolidated nine bakeries in the Middle West. Subsequent to its organization in 1911, the General Baking Co. had acquired several plants at various times, from 1915 to 1924 and had constructed several others. Control of all of these, therefore, as well as the original 21 was acquired by the new corporation. The total number of plants operated by this holding corporation is 42.

The Continental Baking Corporation, the largest of the bakery consolidations, was formed November 6, 1924, through the instrumentality of W. B. Ward and his associates. It first acquired the consolidation known as the United Bakeries Corporation in which this group was also heavily interested and lost no time in obtaining control of many other companies, including a number of previous consolidations, among which were the American Bakery Co., the Standard Bakeries Corporation, Consumers Baking Co., Massachusetts Baking Co. and New England Bakery Co. Other important companies acquired included the Wagner Baking Co., of Detroit; Livingston Baking Co., of Chicago; Corby Baking Co., of Washington; Taggart Baking Co., of Indianapolis; Occident Baking Co., of Minneapolis; Washington Bakeries Corporation, of Seattle, Wash.; Spokane Bakery Co., of Spokane; Perfection Bread Co., of Sacramento; Log Cabin Baking Co., of

Portland, Oreg.; Butter-Krust Baking Co., of Salt Lake City; Ogden Baking Co., of Ogden; and R. B. Ward & Co. (Inc.), of Los Angeles. In 1926 the Continental was operating 91 plants in the United States besides several in Canada.

Effect of the Continental Consolidation on Competition

Because of the apparent effect of the Continental Baking Corporation upon competition, the Federal Trade Commission issued a complaint against this company on April 10, 1925, charging it with the acquisition of the capital stock of certain baking companies in violation of section 7 of the Clayton Act. While this complaint was pending the company secured from its bakery managers, 84 in number, certain sales data designed to show the extent of competing sales at points within and without the State where the bakery was located for one month about six months prior to the acquisition of the company. Total sales and total interstate sales were secured for the week immediately prior to acquisition. These schedules were in the possession of the commission for only a brief time while testimony was being taken in connection with the complaint, but comprehensive abstracts were made of the more essential facts for use in the proceedings. Later, when the original schedules were requested from the company for comparison with the abstracts used in making this report, they were furnished after much delay with the exception chiefly of the sheets showing intrastate sales. Comparison of the schedule material with the abstracts, however, showed the substantial completeness and accuracy of the latter.

In the commission's endeavor to employ for the purposes of this report the sales shown in the schedules as a measure of the competition prevailing between Continental companies prior to their acquisition, great difficulty was experienced because of the noncontemporaneous character of elements essential to a comparison of competing sales with total sales and because of other inadequacies of the material. For this reason additional statistical material of a similar but more comparable character has been requested of the Continental.

From the schedule material two tables were compiled showing the existence of interstate and intrastate competition at many points, but the magnitude of such competition in relation to the total sales or the total interstate sales of the several companies or of the Continental as a whole is not shown by these tables. A third table is presented which shows for each company for the week prior to acquisition its total sales and total interstate sales for both bread and cake separately, with percentages of interstate to total sales computed. The total bread sales of all the reporting companies of the consolidation for the week prior to acquisition were $1,064,309.70, while the total interstate sales for the same period were $89,244.78 or 8.4 per cent. The corresponding proportion for cake was 19.7 per cent. Taking particular companies of the Continental the proportions of interstate bread or cake sales to total bread or cake sales showed a very wide range. The table shows also the reported total competing sales and total interstate competing sales for each company on an average weekly basis for a month about six months prior to acquisition. No total sales or total interstate sales for this period were secured by the company from its

bakery managers. In the absence of these sales, percentages of competing sales for this period to the total sales and total interstate sales for the week prior to acquisition have been computed. These percentages of total competing sales to total sales for the consolidation as a whole are for bread 9.1 and for cake 7.8, while the percentages of total competing interstate sales to total interstate sales are for bread 13.8 and for cake 14.4, but it is very doubtful how far any reliance should be placed on these percentages, because the elements of the comparison are not contemporaneous.

Interlocking Interests

In organization the Ward, General, and Continental corporations have a common parentage. All are apparently the conceptions and creations of W. B. Ward, who organized them either directly or indirectly. Stock lists of the three corporations as of October 31, 1925, show that of the 14 men who were the officers and directors of the Ward Baking Corporation, 10 held stock in both Ward and Continental, 7 in both Ward and General, and 7 in both General and Continental. Six of these 14 held in all three corporations, their holdings in General and Continental being on the whole as large as in Ward Baking Corporation. By direct holdings and through the Ward Foundation Corporation, W. B. Ward was on December 31, 1924, the largest single stockholder in the Ward Baking Corporation. He was also the largest single stockholder in the Continental Co., holding 21 per cent of the voting stock of that company, whereas no other individual owned on that date as much as 5 per cent of the total. For a time, also, all or a considerable part of the voting stock of the General Baking Corporation was controlled by him. These three corporations in which W. B. Ward and his associates were thus interested are now operating about 150 bakeries with an estimated total bread production of close to 20 per cent of the commercial production of the United States.

The Supercombination and Its Dissolution

On January 30, 1926, W. B. Ward caused to be organized under the laws of the State of Maryland the Ward Food Products Corporation This new corporation had every appearance of being organized to take over and hold the stock of the three members of the big three in which W. B. Ward and his associates were interested, i.e., Ward, General, and Continental, in order to make more effectual a control which was apparently already being exercised in some degree. A few days later, therefore, the Government filed a petition in equity in the Federal district court at Baltimore not only against the Continental, but also against the two Ward and the two General companies and various individuals, alleging a violation of the Sherman antitrust law and asking for such injunctions against the companies and individuals as were deemed necessary to prevent such violations by the various parties involved. After extended negotiations a consent decree was entered by the district court, the more important terms of which, so far as the control of the baking industry is concerned, are as follows:

The Ward Food Products Corporation is ordered to be dissolved.

Certain of the individual defendants and the several corporate

defendants are perpetually restrained and enjoined from any act that would bring the several corporate defendants under common control, or that would restrain or monopolize interstate trade in the future.

The corporate defendants are perpetually enjoined from acquiring the whole or any part of the share capital of any other baking corporation engaged in interstate commerce, where the effect of such acquisition may be to substantially lessen competition in such commerce between the corporation whose stock is so acquired and the defendant corporations, or tend to create a monopoly.

The corporate defendants are constituted into three groups, which may be called the Ward, General, and Continental groups, and these groups are severally perpetually enjoined, (1) from acquiring or exercising the control of the whole or any part of the shares of the capital stock of any of the corporations in either of the other groups and from acquiring any of their physical assets; (2) from electing any person as a director or as an officer who is at the same time a director, officer, agent, or employee in any of the corporations of either of the other groups or their subsidiaries; and (3) from entering into any contracts, agreements, or understandings with one or more of the corporations of the other groups for joint purchases of materials, supplies, and equipment, or for common prices or common policies in the marketing and sale of their output.

The individual defendants, William B. Ward, Paul H. Helms, and George G. Barber, are severally perpetually enjoined from acquiring, receiving, holding, voting, or acting as the owners of any of the voting shares of the capital stock of more than one of the defendant corporations and its subsidiaries and from acquiring any of the physical assets of more than one of these corporations, and they a are severally required and agree to dispossess themselves of all voting shares of capital stock in any of the defendant corporations and the companies controlled by them, other than such defendant corporation and its subsidiaries as any of them may elect to retain his holdings in.

The court retains jurisdiction of the case for such further orders and directions as may be "necessary or proper in relation to the carrying out of the provisions of this decree, and for the enforcement of strict compliance therewith and the punishment of the evasions thereof."

Financial Results of Baking Companies

Through direct examination of their books of account and through schedule returns extensive data were secured regarding the investments, profits, and costs of production of commercial bakers, except for the small retail bakers who rarely keep the accounting records necessary for determining such facts. Information was thus obtained from numerous commercial companies, including all the largest ones. The volume of production covered by the figures of rate of profit and cost per pound which was included in the commission's figures in 1923 was more than 25 per cent of the total commercial production of the United States reported by the Census of

Manufactures for that year.

Taking all of the wholesale baking companies, the figures show that they have averaged in each of the six years from 1920 to 1925 about 15 per cent on both company investment and total baking investment, including in investment all intangible assets and all appreciation of tangible assets. On total baking investment, excluding all intangible assets and recent appreciation of tangible assets the return has been much higher, averaging each year around 25 per cent for the same period. Since 1920 the investment in the wholesale baking business has apparently been decreasingly productive. This is indicated by an almost uninterrupted decline in the volume of production and sales per dollar of investment.

During the six years in question these wholesale companies produced several billion pounds of bread at an average cost of 7.154 cents per pound. On this their sales realization averaged 7.861 cents per pound, leaving a net profit of .707 cents per pound. These results are an average for all kinds of bread, it being impossible to show separately figures for different kinds of bread, such as white, whole wheat, graham, and rye, or to distinguish between machine and handmade bread.

Comparisons of the costs of producing bread in large and small plants indicate that on the whole the costs of the larger plants were lower, though there were considerable irregularities in the results for various production size groups for which comparisons were made. Comparisons of the costs per pound of producing and selling bread for the plants of single plant companies and plants of multiple plant companies do not indicate that any decisive advantages are obtained merely by operating more than one plant. The average total costs per pound of the plants of multiple plant companies were a little lower than those of the plants of single plant companies, but this advantage largely disappears when the plants of the two types are compared by size groups. In a majority of the size groups, the single plant companies show lower total costs.

A comparison of the average costs of producing and selling bread by wholesalers (who sell and deliver to retail stores), by house-to-house bakers, and by chain store bakers (who sell over the counter through their own stoes), shows comparatively low producing costs and selling expenses per pound for the chain store bakers. The chain stores show also the lowest average receipts per pound. This apparent superiority, from the point of view of the consumer, of the chain stores over the wholesale bakers, on the average, is not removed, but is enhanced, after due allowances are made for differences in conditions and costs of delivery to the consumer.

By direction of the commission.

C. W. HUNT, Chairman.

The Asphalt Combination

The visible assets of Asphalt Company of America having been sold and their proceeds distributed, . . .it is proper that the Court should be informed of certain matters and things relating to the promotion of Asphalt Company of America, for such action thereupon as the Court may determine should be taken. The facts hereinafter set forth have beenascertained through investigations made by the Receivers continuing from immediately after their apportionment up to the present time.

Asphalt Company of America was incorporated under the laws of the state of New Jersey, June 28, 1899, with an authorized capital stock of $30,000,000, divided into 600,000 shares of the par value of $50. each. The corporation was the outcome of plans previously arranged by and among some or all of the persons hereinafter mentioned as promoters, the essential features of which were (1) the transfer to the corporation of the shares of stock of certain other corporations engaged in the asphalt business and more or less competitive in character, and the issue to the owners of such shares, so transferring their holdings, of Collateral Gold Certificates, in the nature of bond obligations of the new corporation in exchange for said shares of stock, the terms of exchange being mutually arranged, the shares of stock so transferred then being deposited with a trust company (The Land Title and Trust Company being selected) as security for the payment of the interest and principal of the said certificates. (2) The providing of working capital for the new corporation by calls upon its capital stock. In the case of the transfer of the shares of stock by some of the said companies to the new corporation, it was stipulated that, in addition to the purchase price to be paid in Collateral Gold Certificates, the vendors should have the privilege of purchasing stock of Asphalt Company of America , without premium at par, to the amount of 50 per cent of the par value of the stock deposited by them. The following is a list of the corporations whose shares of stock to the amounts and on the terms therein stated were transferred to Asphalt Company, and Collateral Gold Certificates, to the amounts therein mentioned paid therefor:

See next sheet for chart.

The evidence in the possession of the Receiver shows that the persons who transferred to Asphalt Company of America the shares of stock in the above named corporations, receiving Collateral Gold Certificates of the former company therefor, had been holders of shares of stock of some of the companies prior to the inauguration of the plan which was subsequently consummated of transferring them to Asphalt Company of America. In the case of some of the companies, however, some of the vendors who were connected with the organization of Asphalt Company of America as promoters, purchased the whole or some part of the shares which they exchanged for Collateral Gold Certificates on the above terms, after they, with others, had determined upon such organization and either while it was in process of organization or after it was actually incorporated. The essential purpose of this report is to show to the Court the facts which have come to the Receiver's knowledge as to those purchases, and to recommend action thereon.

Name of Company	Total No. of Shares	Par Value	Shares purchased	Price Paid	Cost in Cash	Cost in Certificates
Barber Asphalt Paving Company.	39,000	$100.00	38,993	$300.00	----	$11,697,900.
The New Trinidad Lake Asphalt Company	50,000	48.50	49,550	100.00	----	4,955,000.
			50	84.886	$4244.32	-----
Alcatraz Company of West Virgina . . .	800,000	5.00	799,900	6.00	----	4,799,400.
United Asphalt Company	40,000	100.00	39,975	91.808	----	3,670,000.
Atlantic Alcatraz Asphalt Company. .	1,000	100.00	995	1000.00	----	995,000.
Southern Asphalt Paving Company.. .	250	100.00	245	1020.00	----	249,900.
Alcatraz Paving Co.	1,000	50.00	995	500.00	----	497,500.
Alcatraz Asphalt Paving Company . .	1,000	100.00	995	150.00	----	149,250.
Warren-Scharf Asphalt Paving Company . .	9,500	100.00	9,483	240.00	5618.42	2,278,320.
Utica Paving Co. .	250	100.00	245	510.21	----	125.001.45
Denver Paving Co..	35,000	1.00	34,950	5.714	----	199,714.09
Southwestern Alcatraz Asphalt & Construction Company.	2,000	100.00	1,995	64.16	----	127,999.20
Alcatraz Construction Company.	1,500	100.00	1,495	104.31	----	155,943.45

The organization of Asphalt Company of America appears to have been under consideration as early as March 6, 1899, and to have been entered upon very shortly thereafter. At that time the following persons appear to have been holders of record of shares of stock of some of the corporations which were subsequently combined in the manner above stated, to about the following amounts:

	Barber Asphalt Paving Company	The New Trinidad Lake Asphalt Compan
	Shares	Shares
Amzi L. Barber held. . . .	5507	4394
Francis V. Greene held . .	900	1822
George W. Elkins held . .	1831	1639
J. J. Albright held . . .	2613	3050
Edmund Hayes held	1264	2131
C. K. Robinson held . . .	281	997
E. Burgess Warren held.. .	5164	4849
Wm. L. Elkins held . . .	500	---
Geo. D. Widener held . . .	1091	1273

Dunes Asphalt Pro-					
ducts, Inc.	20,000	----	----	----	[illegible]
Sun Oil Company					
Lone Star Industrial					
Products Co.	50,000	48.50	46,560	100.00	----
Allwine Refinery of					
West Virginia	800,000	5.00	799,800	6.00	----
Dalton Asphalt					
Co.	[illegible]	[illegible]	[illegible]	[illegible]	----
Lincoln Asphalt					
Company, Inc.	1,000	100.00	995	1000.00	----
Southern Asphalt					
Refining Co.	820	100.00	245	1020.00	----
Atlantic Refining Co.	1,000	80.00	995	800.00	----
Atlantic Asphalt					
Corporation	1,000	100.00	995	180.00	----
Texas Co.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Barton-Sharp Asphalt					
Paving Co.	250	100.00	245	310.00	----
Utah Paving Co.	35,000	94.00	34,950	5.714	----
Sayre Paving Co.					
Southwestern Asphalt					
Products & Construction					
Company	2,000	100.00	1,995	84.16	----
Atlantic Construction					
Company	[illegible]	[illegible]	[illegible]	[illegible]	----

	Alcatraz Company of West Virginia	Denver Paving Co
	Shares	Shares
William H. Crocker held. . . .	401,320	1863

	Alcatraz Paving Co.	Southwestern Alcatraz & Construction Co.
	Shares	Shares
William J. Latta held. . . .	30	---
Harry C. Spinks held . . .	--	585

Some of the above named parties then acquired shares of stock of other companies subsequently turned into the combination, and they also acquired more shares of stock of some of the companies in which they already had interests. Some of the shares of stock so acquired were then transferred to Asphalt Company of America, when incorporated, at prices payable in Collateral Gold Certificates in excess of the prices at which they were respectively obtained by the purchasers, and the Receiver believes that further investigation will show that all of said shares were transferred by the said purchasers to Asphalt Company of America at a profit. So far as the Receiver knows, no disclosure to Asphalt Company of America was made by the persons who so transferred their shares of stock to it of the profits received by them. All of the above named parties, it is believed, were beneficially interested in the acquisition of some of said shares, and in their transfer to Asphalt Company of America.

The facts in detail for the consideration of the Court follow:

As to United Asphalt Company.

Amzi L. Barber, Francis V. Greene and George W. Elkins each transferred to Asphalt Company of America 13,325 shares of stock of this company, aggregating 39,975 shares. Amzi L. Barber and George W. Elkins each received therefor $1,223,300, and Francis V. Greene received $1,223,400, in Collateral Gold Certificates of Asphalt Company of America, the said three parties receiving as a whole $3,670,000 of said certificates. At the time of said transfers United Asphalt Company was the holder, either in its corporate name, or by its representatives, of practically the entire capital stock of four corporations known as Columbia Construction Company, of New York; Trinidad Bituminous Asphalt Company, of New Jersey; Standard Asphalt Company, of New Jersey, and Rock Creek Natural Asphalt Company of Kansas. The shares of capital stock of these corporations constituted its entire assets. The evidence in the possession of the Receiver points to the fact that these shares of stock were bought by or under the direction of Amzi L. Barber, Francis V. Greene and George W. Elkins, with money or obligations furnished, or procured, by them to be furnished as follows:

For the stock of Columbia Construction Company. . .	$250,000
" " " Trinidad Bituminous Asphalt Company. .	150,000
" " " Standard Asphalt Company	200,000
" " " Rock Creek Natural Asphalt Company . .	18,000
	$618,000

Said purchases were made between March 21 and August 4, 1899. In the meantime United Asphalt Company had been organized as a holding company, and on July 12, 1899, 13,325 shares of its capital stock were issued to Amzi L. Barber, Francis V. Greene and George W. Elkins each, making 39,975 shares in the aggregate, issued to them out of a total capital stock of 40,000 shares. The above 39,975 shares were subsequently, on July 15, 1899, transferred to Asphalt Company of America for $3,670,000 of its Collateral Gold Certificates. The first sales of the Temporary Certificates standing for said Collateral Gold Certificates were in August, 1899, in the neighborhood of 90 per cent of par. Taking the value of the Collateral Gold Certificates at 97 per cent of par, the highest price at which said certificates sold, the profit each of the said three parties to said transaction was about $980,601, and to all of them together was about $2,941,803. Taking the value of the said certificates at 89½ per cent of par, which was their lowest market price in August, 1899, the profit to each of said parties was about $888,853.50, and to all of them together was about $2,666,560.50.

As to Warren-Scharf Asphalt Paving Company.

Amzi L. Barber, Francis V. Greene and George W. Elkins each transferred to Asphalt Company of America 3164 shares (George W. Elkins transferring 3165 shares) of stock of Warren-Scharf Asphalt Paving Company, aggregating 9493 shares out of a total capital stock of 9500 shares. They each received therefor $759,360 (George W. Elkins receiving $759,600) in Collateral Gold Certificates. The said three persons received as a whole $2,278,320 par of said certificates.

The said three persons had previously purchased from the then owners the said shares of stock at an outlay to them of about $1,500-000, and the said shares were transferred into their names on July 27, 1899. The transfers of said shares by them to Asphalt Company of America were made on July 31, 1899, and the above mentioned temporary certificates of said company were issued to them therefor. Taking the value of the Collateral Gold Certificates at 97 per cent of par, the profit to each of the said three parties to said transaction was about $236,579, and to all of them together was $709,970. Taking the market value of the certificates at 89½ per cent of par, the profit to each of the said parties was about $179,627.20, and to all of them together about $539,096.

From certain papers in the possession of Receiver it would appear that the moneys necessary to purchase said shares of stock from the preceding holders were contributed by the following parties in the following proportions, and the Receiver believes that distribution of Collateral Gold Certificates was made to said parties in proportion to their contribution to purchase money as follows, and that they shared the profits proportionately:

	Payment of Purchase Money	Distribution of Collateral Gold Certificates
J.J. Albright.	$115,875	$176,130
A. L. Barber	233,175	334,426
F. V. Greene	50,550	76,836
Edmund Hayes	64,950	98,724
C. K. Robinson	20,325	30,894
Geo. D. Widener	49,800	75,696
E. B. Warren	215,325	327,294
Geo. W. Elkins	250,000	380,000
Wm. L. Elkins	250,000	380,000
Sydney F. Tyler	250,000	380,000

As to The New Trinidad Lake Asphalt Company, Limited.

Shortly after the organization of Asphalt Company of America was projected, the Board of Directors of Barber Asphalt Company, which company owned 1718 shares of the capital stock of The New Trinidad Lake Asphalt Company, Limited, caused said shares to be offered for sale to its stockholders. This action was taken pursuant to the authorization of its Executive Committee, acting as a Board of Directors, on March 15, 1899, the said Board of Directors being composed at the time of the following persons: J. J. Albright, Amzi L. Barber, Francis V. Greene, Edmund Hayes, C. K. Robinson, George D. Widener, George W. Elkins, E. Burgess Warren, and P. W. Henry. 1638 of the said shares of stock of The New Trinidad Lake Asphalt Company, Limited, were thereupon brought by the stockholders of Barber Asphalt Paving Company at the limit fixed by the Executive Committee in its resolution for their sale, to wit, $48.50 per share. 1515 of the said shares so bought were purchased and paid for by the following persons who were also Directors of Barber Asphalt Paving Company at the rate of $48.50 per share, to wit:

J. J. Albright.	.210	shares
Amzi L. Barber	.206	"
Francis V. Greene	.178	"
Edmund Hayes	.209	"
C. K. Robinson	.103	"
George D. Widener	.207	"
George W. Elkins	.211	"
E. Burgess Warren	.211	"

After said purchases of said shares of stock at $48.50 per share, they were transferred to Asphalt Company of America at the valuation of $100 per share and Collateral Gold Certificates were received in exchange therefor to the amount in the aggregate at par of $151,500.

The Receiver believes it can be established that the said parties shared in the profits of said purchases and sales in proportion to their said holdings.

Taking the Collateral Gold Certificates at 97 per cent of par, the profit to said parties from the said purchases and transfers amounted to $73,477. Taking the value of the Collateral Gold Certificates at 89½ per cent of par, the profit to the said parties amounted to $62,515.

As to Alcatraz Company.

William H. Crocker transferred to Asphalt Company of America on or about August 3, 1899, 799,650 shares of the capital stock of Alcatraz Company of West Virginia. Prior to the formation of the plan of organization of the Asphalt Company of America the said Crocker was the holder of record of 401,320 shares of said company, the balance of the holdings transferred by him to Asphalt Company of America, to wit, 398,330 shares, having been acquired by him after March 8, 1899. The Receiver has not as yet been able to obtain information as to the amount paid by the said Crocker for said 398,330 shares transferred into his name after the organization of Asphalt Company of America was determined upon, nor what profit, if any, was made by him on the purchase or other acquisition by him of said shares and the sale thereof to Asphalt Company of America.. The said shares, with the other shares previously held by him ($5 par value), were transferred to Asphalt Company of America at the rate of $6 per share, payable in Collateral Gold Certificates. The actual sum received by him in Collateral Gold Certificates for the shares obtained by him after the plan of organization of Asphalt Company of America was determined upon was at par $2,389,980. The Receiver has reason to believe that a substantial profit was made by the said Crocker in said transaction. He is advised that the relation of the said Crocker to the enterprise was that of a promoter, and that whatever profit was obtained by him he is in law obliged to pay to the Receiver of the Asphalt Company of America.

As to Denver Paving Company.

The said William H. Crocker transferred to Asphalt Company of America 28,725 shares of Denver Paving Company stock at the rate of $5.71 428/1000 per share (the shares being $1 par) and received in exchange therefor at par $164,143.69 in Collateral Gold Certificates. He was the holder of record prior to the formation of the plan of organization of Asphalt Company of America of only 1863 of said shares. The balance of his holdings transferred to Asphalt Company of America as aforesaid, 26,862 shares, appears to have been acquired by him after the plan of organization of Asphalt Company of America was entered upon. The actual sum received by him in Collateral Gold Certificates for said shares, so as aforesaid subsequently obtained, was at par $153,496.98. The Receiver has reason to believe that a substantial profit was made by the said Crocker in the said transaction. He is advised that the relation of the said Crocker to the enterprise was that of a promoter, and that whatever profit was obtained by him, he is in law obliged to pay to the Receiver of Asphalt Company of America.

As to Alcatraz Paving Company.

William J. Latta transferred to Asphalt Company of America, in July, 1899, 305 shares of Alcatraz Paving Company ($100 par) at the rate of $500 per share, payable in Collateral Gold Certificates of Asphalt Company of America. The actual sum received by him for the said shares, payable in Collateral Gold Certificates at par aforesaid, was $152,500. Prior to the formation of the plan of organization of Asphalt Company of America the said Latta was the ho holder of record of only 30 of said shares of stock. He appears to have acquired 275 of the shares transferred to Asphalt Company of America as aforesaid after said date. The actual sum received by him in Collateral Gold Certificates for said 275 shares was $137,500. The Receiver has reason to believe that a substantial profit was

made by the said Latta in said transaction. He is advised that the relation of the said Latta to the enterprise was that of a promoter and that whatever profit was obtained by him he is in law obliged to pay to the Receiver of Asphalt Company of America.

As to Southwestern Alcatraz Asphalt & Construction Company.

Harry C. Spinks transferred to Asphalt Company of America on or about August 10, 1899, 1995 shares of the stock of the Southwestern Alcatraz Asphalt & Construction Company at the rate of $64.16 per share, payable in Collateral Gold Certificates of Asphalt Company of America. He received therefor in said certificates at par $127,999.20. The said Spinks actually held of record prior to the entry upon the plan of organization of Asphalt Company of America only 585 of said shares. The evidence in the Receiver's possession indicates that he obtained from various other persons after said date 1410 of said shares which he transferred to Asphalt Company of America upon the total consideration payable in Collateral Gold Certificates at par $90,465.60. The Receiver has not as yet been able to ascertain what profit the said Spinks made out of the purchase of said shares and the transfer thereof to Asphalt Company of America. He is advised, however, that the relations of the said Spinks to the organization of Asphalt Company of America were such that he is obliged to account for and pay over whatever profit he obtained in connection with the said transaction.

From the facts which have come to the knowledge of the Receiver he believes that some or all of the parties above named, to wit, Amzi L. Barber, Francis V. Greene, George W. Elkins, J. J. Albright, Edmund Hayes, C. K. Robinson, E. Burgess Warren, William L. Elkins, George D. Widener, Sydney F. Tyler, William H. Crocker, William J. Latta and Harry C. Spinks, can be established to have been promoters of Asphalt Company of America, and that they made profits in connection with its organization in the manner above stated, which they are obliged to account for, and that they can be compelled to account for and pay over the same. He therefore recommends, the premises considered, that he be authorized by the Court to take such proceedings against the said parties, or any of them, by suit or suits in law or equity, as he may be advised are proper, and as he may deem expedient under the facts as they exist and shall be made to appear upon further investigation, with a view to collecting all profits that were made by the said persons, or any of them, in connection with the organization of Asphalt Company of America and the transfer of securities to it. He also recommends that he be authorized to bring like proceedings against any other persons whom he may hereafter ascertain to have obtained such profits.

He respectfully calls attention of the Court to the fact that an Act of Limitation was passed by the Legislature of the state of New Jersey at the last session, approved the 8th day of April, 1903, which limits the period during which suits may be brought against directors, officers, promoters and other agents of corporations of the state to recover unlawful profits made by them, to the period of four years from and after the making or receipt of such profits. A saving clause being, however, incorporated in the said Act which permits such suits which otherwise would be barred to be brought within six months after the Act took effect. The result of the passage of the said Act is that proceedings against promoters in connection with Asphalt Company of America with a view to the recovery of unlawful profits obtained by them as the Receiver is

advised, must be begun before October 8, 1903. He therefore respectfully urges upon the Court the desirability, if it should seem proper that the Court instruct that any suits of this kind be brought, that the authorization to him to so proceed be given forthwith.

Respectfully submitted,
Henry Tatnall,
Receiver Asphalt Company of America

July 6, 1903

It is scarcely to be expected that a company launched under the conditions described in the foregoing report should have a successful career. Two reorganizations promptly followed in less than four years. The original Asphalt Company of America, organized in July, 1899, acquired the stocks of a large number of competing concerns, issuing in payment therefor $30,000,000 of collateral trust bonds. These bonds were issued on the sedurity of the stock so acquired. The next step was to assure the control of the enterprise by the promoters through ownership of a majority of the capital stock. Accordingly practically all of the original stock subscriptions were taken in the name of two dummies. A large part of this issue of original stock was immediately turned over to the promoters, giving them virtual control of the enterprise. The stock was not paid for in full, but an amount equivalent to 20 per cent of the par value, which was $50 per share, was actually paid. The funds to meet this partial payment on the stock held by the promoters were raised by a sale of the balance of the stock not held by insiders to the public at prices ranging as high as $19 per share. Thus did the promoters acquire control of the holding company without any additional investment on their part; and at the same time possess themselves of a volume of bonds, which, on the basis of the excessive payments described in the preceding report, proved more than sufficient to absorb the entire earnings of the consolidation.

The existence of a stockholders' liability for the remaining four-fifths of the par value of the capitalstock was the cause of the speedy reorganization of the company in May, 1900. By reason of fraudulent and reckless accounting, as partially indicated by our preceding reprint, the inevitable bankruptcy of the parent company was hidden from the public temporarily. In brief, the Asphalt Company of America was superseded in May, 1900, by a new company entitled the National Asphalt Company. This new corporation issued $6,000,000 of Collateral Gold Certificates which were used to take up the stock of the old corporation. In addition, its own capital, amounting to $22,000,000, was used in part to acquire control of formidable competitors who had invaded the field, and in part as a bonus to secure deposit of the old underlying bonds. In December, 1901, this company, in turn, went into the hands of a receiver. Then began a long series of suits and countersuits in connection with the activity of a reorganization committee; which, judged by results, seems to have been working in the interest of insiders. The outcome of the matter was the final organization in May, 1903, of the General Asphalt Company which acquired the properties of its predecessors, sold at auction for a trifle over $6,000,000. This General Asphalt Company was capitalized at $31,000,000, in place of $60,000,000 of stock and bonds issued by the original Asphalt Company of America. The troublesome underlying bonds of the first company were to be retired by exchange for preferred stock; and the common stock was issued in part to raise working capital.

A partial recovery of the enormous losses by innocent investors could be effected only in two ways. Successful suits against the promoters for unrevealed profits in the organization of the company might be hoped for, following precedents in a number of recent cases, notably that of the East Tennessee Land Company. In addition it was possible that the Receiver might be able to hold the original stockholders liable for the balance of their payments on the capital stock of the Asphalt Company of America. This latter should amount to about $24,000,000, while at the same time it was hoped that nearly $3,000,000 could be extorted from the promoters. The first of these remedies against the promoters, however, has now been closed through purchase by the promoters themselves of all the outstanding bonds. As representing all the creditors of the company, they have asked the Court to discontinue the suits. This has been done. Moreover, the Receiver has abandoned the attempt to assess the stockholders for their unpaid capital stock on the ground that such suits cannot be successfully prosecuted. Thus close a story of fraud and financial rottenness not less enlightening than that of the United States Shipbuilding Company, as showing the necessity for provision by law to secure a reasonable amount of publicity in the finances of monopolistic combinations. -- Ed.

Reading No. 29

The Tobacco Monopoly
History of the Tobacco Combination

From Report, U.S. Bureau of Corporations

The Tobacco combination has as its center the American Tobacco Company. This company controls three great subsidiary combinations - the American Snuff Company, the American Cigar Company, and the British-American Tobacco Company. The American Tobacco Company and the other three combinations each control a large number of subsidiary companies. The number of companies in the combination doing business in the United States, Porto Rico, and Cuba is 86, besides a considerable number operating only in foreign countries.

The Tobacco combination dominates the tobacco industry of the United States. With the exception of cigars, its proportion of the country's output of manufactured tobacco products is substantially four fifths, giving it a large degree of monopoly power.

The magnitude of the combination is further shown by its enormous capitalization. The said 86 companies have an aggregate capitalization, including bonds, of $450,395, 890. A considerable part of this, however, represents duplication through intercompany ownership of securities. The net amount of the stock and bonds of the companies in the hands of the public (including the directors and all holders except the companies themselves), however, is no less than $316,346,821.

The American Tobacco Company and Its Cigarette Monopoly, 1890 to 1895

The history of the combination begins with the organization of the American Tobacco Company in 1890. This was a combination of the five principal manufacturers of cigarettes, and its business at first was confined substantially to cigarette manufacture. The company started with a capital of $10,000,000 of preferred stock and $15,000,000 of common stock - an amount vastly in excess of its tangible assets, which were $5,000,000 (including $1,825,000 in the form of notes of the individual stockholders). James B. Duke was made president, and from that time to this he has been president of the leading companies in the combination and has largely directed its policy.

The American Tobacco Company at its inception secured control of over 90 per cent of the cigarette business of the country. It sought to maintain this dominant position partly by making agreements for the exclusive use of what were considered the best cigarette machines; the most important of these agreements, however, was terminated in 1895. During this period, 1890 to 1895, the average profits of the company were very large, exceeding four million dollars annually

The Plug-Tobacco War, 1894 to 1897

The American Tobacco Company early began to extend its domination to cover other branches of the tobacco industry. In 1891 the authorized capital was increased to $35,000,000. Of this increase $6000000 was common and $4,000,000 perferred stock. In this year thecompany bought two important concerns manufacturing smoking tobacco and snuff, another manufacturing plug chewing tobacco, and a fourth which was

the principal manufacturer of cheroots in the United States. During the period from 1894 to 1897 it developed its plug-tobacco business with such a degree of success that ultimately its leading competitors in that branch were forced into combination with itself.

In pursuit of its policy of expansion the American Tobacco Company, particularly after 1894, sold plug tobacco at greatly reduced prices. Its leading fighting brand bore the appropriate name of "Battle Axe". At one time this brand was sold to jobbers as low as 13 cents per pound, which, considering the revenue tax, was below the cost of production. The company's immense profits from its cigarette business furnished the means for conducting this expensive competitive struggle, in which several millions were sacrificed. The American Tobacco Company's plug business increased swiftly, and by 1897 it had more than one fifth of the total plug output of the country. To enable the company to fill its orders, an additional plug plant was purchased in 1895, and another erected.

The Plug-Tobacco Combination, 1898-1899

By 1898 a number of the leading independent manufacturers of plug tobacco had wearied of the fierce competitive struggle and were prepared to consider propositions for combining their interests with those of the American Tobacco Company. The first negotiations, early in 1898, were, however, unsuccessful, partly by reason of the increase in taxes during the Spahish-American war, which appeared to the financiers who were promoting the enterprise likely to interfere with its profitableness. Shortly thereafter the American Tobacco Company bought outright two important plug-manufacturing concerns - the Brown Brothers and Drummond tobacco companies, of St. Louis. This greatly strengthened the position of the American, and it apparently determined to renew the vigorous competition of the preceding years against its powerful rivals. For this purpose the price of "Horseshoe", the leading brand of the Drummond concern, was sharply reduced.

Before this new competitive fight had become very active, however, further negotiations for combination began. The plug combination, known as the Continental Tobacco Company, was organized on December 10, 1898. It took over the plug business of the American Tobacco Company, including the Brown and Drummond concerns, and also that of six leading competitors, while a few months later the most important competitor of all, the Liggett & Myers Tobacco Company, was also brought into the combination. Several of the concerns acquired had also a large business in smoking tobacco. Although the American Tobacco Company did not at that time own a majority of the stock of the Continental Tobacco Company, the men connected with the American were, from the very first, dominant in the Continental's directorate.

The Continental Tobacco Company issued at the time of its organization $62,290,700 of stock. This amount was still further increased in April, 1899, by reason of the acquisition of the Liggett & Myers concern. The total issue then became $48,844,600 of preferred stock, and $48,846,100 of common stock, or $97,690,700 altogether, an amount which thereafter remained unchanged. The company was greatly overcapitalized, the common stock being issued wholly as a bonus. Much the greater part of both classes of stock was given directly in exchange for the property and business acquired. The company issued $15,137,106 of preferred and a like amount of common stock for the property and business turned over by the American Tobacco Company;

$17,500,000 each of preferred and common for $5,000,000 in cash and the property and business of the Liggett & Myers Tobacco Company; and $13,456,100 in preferred and $16,207,500 in common stock for the property and business of other concerns. From the beginning the American Tobacco Company had complete control over the new combination.

Entrance of Financiers into the Management

The acquisition of the Liggett & Myers Tobacco Company by the Continental, just referred to, was part of a series of transactions which had a most important influence upon the personnel of both the American and Continental tobacco companies. During 1898 a group of powerful financial interests, including Thomas F. Ryan, P. A.B. Widener, A.N. Brady, W. C. Whitney, and Thomas Dolan, bought up the Blackwell's Durham Tobacco Company, an important manufacturer of smoking tobacco, and the National Cigarette and Tobacco Company, combining them under the name of the Union Tobacco Company. They also secured an option upon a controlling portion of the stock of the Liggett & Myers Tobacco Company, control of which of course was very important to the new plug combination. Mr. Duke and his associates in the American and Continental companies realized the seriousness of the possible competition of the Union Tobacco Company interests, backed by these wealthy financiers. They therefore entered into negotiations with these financiers and bought out the properties they controlled at a high price. In the spring of 1899 the assets of the Union Tobacco Company proper were taken over by the American Tobacco Company in exchange for $12,500,000 common stock. Shortly afterwards, through another syndicate, composed in part of the men above mentioned, but also including J.B. Duke, O.H. Payne, and H. D. Terrell, the Liggett & Myers Tobacco Company assets, together with $5,000,000 in cash, were transferred to the Continental Tobacco Company in exchange for $17,500,000 of its common stock and $17,500,000 of preferred stock.

These transactions were important, not only because they still further inflated the capitalization of the two companies, but because they resulted in giving a very large stock interest in both to the financiers who had organized the Union Tobacco Company. Most of these men shortly thereafter entered the directorate of either the American or Continental company, or both, and from that time on have been important factors in the control of the entire Tobacco combination.

Already before this time there had been marked changes in the directorate of the American Tobacco Company. The campaign for control of a large part of the tobacco industry, which has just been recounted had not been favored by most of the leaders in the original cigarette combination. Consequently,
Ginter, Kinney, Kimball, and Emery, (owner of Goodwin & Co.) had practically disposed of their interests in the American Tobacco Company by the spring of 1898. Indeed, none of them was a director in that company after the spring meeting of 1897,

This defection of most of the large stockholders among those who had organized the original combination found other men, possessed of large capital but without previous experience in tobacco manufacture, ready to avail themselves of the opportunity offered. During the latter part of 1897 and early in 1898 Oliver H. Payne and H. L. Terrell invested freely in stocks of the American Tobacco

Company and were elected directors. At about this time Moore & Schley New York bankers and brokers, also established close relations with the combination. They financed the organization of the Continental Tobacco Company. These new men, together with those who entered the management as the result of the Union Tobacco Company transaction, have had a powerful influence in the subsequent expansion policy of the combination, both by furnishing capital and in other ways.

At the time of the purchase of the Union Tobacco Company the American Tobacco Company paid, out of its accumulated surplus and the profits of the sale of its plug business to the Continental, a stock dividend of 100 per cent, or $21,000,000, to its common-stock holders. This, with the stock issued for the Union, added $33,500,000 to the company's capital stock and almost doubled the capitalization already existing. From this time on until 1904, the capitalization of the American Tobacco Company consisted of $54,500,000 of common stock and $14,000,000 of preferred stock.

The Snuff Combination

Within a short time after the organization of the Continental Tobacco Company the combined interests obtained control of practically all the leading snuff concerns of the country. Ever since 1891 the American Tobacco Company had had a small snuff business. The Continental had acquired the extensive snuff business of the P. Lorrillard Company, and in 1899 the American Tobacco Company acquired two or three additional snuff concerns. The two companies together had at the beginning of 1900 substantially one third of the snuff business of the country. About two years before this, however, a combination of the important strong Scotch snuff-manufacturing concerns of the country had been effected independently of the American and Continental interests, under the name of the Atlantic Snuff Company. The output of this concern was greater than that of the Continental and American together. During 1899 a vigorous competitive warfare was conducted between these two groups of interests. Early in 1900, however, they came together in the formation of the American Snuff Company, which also took in another important concern, the George W. Helme Company.

The American Snuff Company was organized on March 12, 1900. It issued $12,000,000 of 6 per cent preferred and $11,001,700 of common stock. The American and Continental interests (including the Lorillard Company) received $10,000,000. the Atlantic Snuff Company intersst $10,000,000, and the Helme Company $3,000,000 of the stock. The Atlantic Snuff Company interests, however, obtained three quarters preferred and one quarter common stock, while the American Tobacco Company interests received only one quarter preferred and three quarters common. The common stock was at first considered of much less value than the preferred; but with the growing prosperity of the business arising largely from the almost complete monopoly the common stock has now become the more valuable. It has paid regularly for several years 10 per cent dividends, while the company has also accumulated a large surplus.

The Combination's Control of the Industry in 1900.

The organization of the Continental Tobacco Company, the American Tobacco Company's acquisition of the Union Tobacco Company and of other concerns in 1899, and the formation of the American Snuff Company at once raised the Tobacco combination to a dominant position in the manufacture of all the important kinds of tobacco except cigars.

In 1900 the combination had 62 per cent of the national output of plug tobacco and 59.2 per cent of the output of smoking tobacco; in 1901 the first full year of the American Snuff Company, it had 80.2 per cent of the output of snuff. In 1897 the American Tobacco Company had controlled barely a fifth of any one of these products. The combination, moreover, still retained substantially a monopoly control over the cigarette business, making 92.7 per cent of the national output in 1900.

The Cigar Combination

Last of all the combination turned its attention to the cigar business, the most important of all the branches of tobacco manufacture, but also the most difficult in which to make an effective combination, because of the immense number of concerns in the trade.

Since 1891 the American Tobacco Company had had a considerable business in the manufacture of cheroots, but had made no ordinary cigars. Soon after the organization of the Continental Tobacco Company, however, the American began plans to enter the cigar business. Inasmuch as it had found that its position in the cigarette business had been greatly strengthened by the control of machine patents, it began experimentation with machines for making cigars. Up to the present time, however, machinery has become of comparatively little importance in the manufacture of any but the cheaper types of cigars. Nevertheless, the American Tobacco Company interests in 1901 entered extensively into the cigar business by the organization of the American Cigar Company.

This company, incorporated January 12, 1901, started with an authorized capital stock of $10,000,000, of which $9, 965,000 was issued. The Continental and American tobacco companies each took $3,500,000 of the stock. Soon afterwards $10,000,000 of ten-year gold notes were issued by the American Cigar Company, guaranteed by the same two companies. In 1905, $10,000,000 of preferred stock was issued.

The American Cigar Company took over the greater part of the cheroot and small-cigar business of the American Tobacco Company, and proceeded to buy up a number of existing cigar manufacturing concerns. The most important was Powell, Smith & Co., an arrangement for the absorption of which had been made even before the organization of the American Cigar Company. Another important acquisition was that of the Havana-American Company, a combination which had been established by other interests in 1899 and which controlled an annual output of about 100 million high-grade cigars, chiefly made from Cuban tobacco.

The acquisitions made by the American Cigar Company in 1901 immediately made it the largest single manufacturer of cigars in the country, but it did not then possess, and has never since possessed, any large proportion of the total cigar business of the United States. During the years 1901 to 1903, however, it greatly increased its output, though only at the expense of heavy losses, due to extravagant advertising and schemes and deals in connection with the American and Continental companies. In 1903 it had about one sixth of the cigar output of the United States.

The new capital made available by the Consolidated Tobacco Company, which was organized soon after the American Cigar Company, was in part used in this expansion of the Cigar business.

The Consolidated Tobacco Company, 1901

The Consolidated Tobacco Company, organized in June, 1901, still further cemented the union between the two principal combinations- the American and Continental companies - by acquiring nearly the entire amount of the common stock of both. The Consolidated also gave still more complete control to the few men who were already the leaders in the management and gave them the surplus profits of the business. An immediate object, however, was to secure additional capital for the expansion of the business of the combination, partidularly in the cigar industry and in foreign countries.

The Consolidated Tobacco Company had at the outset a capital stock of $30,000,000, which was paid in in cash; this was increased to $40,000,000 at the end of 1902. Immediately after its organization, the Consolidated issued a circular, giving the names of its directors, who were mostly men already in the directorates of the other two companies, and offering to exchange its 4 per cent bonds in equal amounts for the common stock of the Continental Tobacco Company, and to exchange them at the rate of $200 for $100 for the common stock of the American Tobacco Company. The offer was promptly accepted by nearly all the stockholders. Ultimately the amount of bonds issued by the Consolidated for this purpose became $157,378,200, with which $54,274,550 of American and $48,829,100 of Continental common stock were acquired. The exchange of a double amount of bonds for the American Tobacco Company stock meant, of course, a still larger overcapitalization as compared with the actual investment.

The owners of the stock of the Consolidated thus acquired effective control of both the American and the Continental, and became entitled to all the profits of both in excess of the fixed amounts required for dividends on their preferred stocks and for interest on the Continental bonds. This exchange of stock for bonds had appeared at the time highly advantageous to the common-stock holders of the American and Continental companies. The Continental common stock had never paid a dividend, and during much of the time had sold at between $20 and $30 per $100 share; the holders were now guaranteed 4 per cent on the par vallue. The American Tobacco Company's common stock, since the declaration of the 100 per cent stock dividend in 1899, had paid only 6 per cent, and the exchange was equivalent to a guaranty of 8 per cent. The actual earnings of the company were about 9 per cent.

Nevertheless, the transaction actually proved enormously profitable to the men who organized the Consolidated Tobacco Company. Those men had been for the most part in the directorates of the American and Continental companies, and they were in a far better position than most outside stockholders to form a correct judgment as to the probable great increase in profits that was likely to occur in the near future.

The probability of such an increase in profits lay in the changes in the internal-revenue taxes on tobacco products. Those taxes had been greatly increased in 1898, to provide funds for the Spanish War. Already, before the organization of the Consolidated, Congress had passed an act to reduce the tax on "manufactured tobacco" (i.e., chewing and smoking tobacco) and snuff from 12 cents to 9.6 cents per pound and that on cigarettes from $1.50 to $1.08 per thousand (54 cents for cheap grades). This reduction was to take effect on July 1, 1901, or a few weeks after the Consolidated was established,

the principal original

companies ... stock of both. The Consolidated also complete control to the former, ... already ... company and gave these two ... important ... however, ... the extension of the ... of the combination, particu- cigar industry and in foreign countries.

Consolidated Tobacco Company had at the outset a capital 000,000, which was paid in in cash; this was increased at the end of 1903. Immediately after its organization issued a circular, giving the names of its directors, ... already on the directorates of the other two com- offering to exchange its 4 per cent bonds in equal amounts stock of the Continental Tobacco Company, and to ex- at the rate of $200 for $100 for the common stock of the ... Company. The offer was promptly accepted by nearly ... Ultimately the amount of bonds issued by the for this purpose became $157,378,200, with which of American and ... of Continental common stock ... The creation of a double amount of bonds for the ... Company stock meant, of course, a still larger ... italization as compared with the actual investment.

... of the stock of the Consolidated thus acquired all of both the American and the Continental, and became all the profits of both in excess of the ... dividends on their preferred stock and the interest on ... bonds. This exchange of stock for bonds had appeared highly advantageous to the common-stock holders of the Continental companies. The Continental common stock ... paid a dividend, and during most of the time had sold ... and 250 per $100 share; the holders were now guaranteed ... on the par value. The American Tobacco Company's com- ... the declaration of the 100 per cent stock dividend ... only 6 per cent, and the average ...

cent.

... the transaction actually proved enormously profit- ... who organized the Consolidated Tobacco Company. Those ... for the most part in the directorates of the American ... companies, and they were in a far better position ... the stockholders to form a correct judgment as to the ... increase in profits that was likely to occur in the

... of such an increase in profits lay in the changes ... taxes on tobacco products. These taxes ... in 1898, to provide funds for the Spanish ... the organization of the Consolidated, Congress ... reduce the tax on manufactured tobacco (i.e., ... tobacco) and snuff from 12 cents to 9.6 cents ... from $... to $... per thousand ... This reduction was to take effect on ... was established.

Presumably, also, the directors of that concern foresaw that the tax on manufactured tobacco and snuff would be still further reduced later, to bring it back to the basis which had existed before the war. This actually occurred in 1902, when it was made 6 cents. When the tax had been advanced, the manufacturers of tobacco had barely been able to raise prices sufficiently to recoup themselves; but the men connected with the Consolidated evidently foresaw that prices would not have to be reduced by an amount at all commensurate withthe reduction in the taxes - particularly in view of the large proportion of the business now possessed by the combination and its consequent large measure of control over prices - and that consequently profits would greatly increase.

Such, in fact, proved to be the case. On the basis of the rate of earnings of the American and Continental prior to the formation of the Consolidated, it would scarcely have been possible to pay dividends on their preferred stocks and interest on the Consolidated bonds. During the three years and four months following the organization of the Consolidated, however, the earnings of the two companies were sufficient to pay those charges and also to leave a profit of fully $30,000,000 to the Consolidated on its investment of $30,000,000 (part of the time $40,000,000). That company during this period of time paid $6,000,000 in dividends, accumulated a surplus of $17,000,000 and substantially became entitled also to the increase in the surpluses of the American and Continental Companies, amounting to over $7,000,000.

The benefit of this increase in profits was, by reason of the organization of the Consolidated, largely concentrated in the hands of a few men. This is seen in the face that immediately after the organization of the Consolidated more than half of its shares were held by six men - James B. Duke, A. N. Brady, O. H. Payne, Thomas F. Ryan, P. A. B. Widener, and William C. Whitney. Through the ownership of the stocks of the American and Continental by the Consolidated, these six men were, moreover, in position to dominate the entire combination. The same six men had just previously owned only a minority of the stocks of the American and apparently very little of the Continental, though they had been very powerful in the management of both. Most of these men, it will be observed, were the financiers who had entered the combination in 1898 and 1899. They and a few associates had supplied the greater part of the new capital now made available for the expansion policy; but they did so only because it was evident that, through the organization of the Consolidated, they might enormously increase their power and their share in the prospective profits of the business.

The British Campaign of the Combination, 1901-21

Combination in the Cuban Cigar Business, 1902

Another direction in which expansion was now sought was in cigar manufacture. Here, too, the new capital furnished by the Consolidated was useful. Aside from the activity of the American Cigar Company in the domestic trade, already referred to, that company now undertook to secure a dominant position in the important cigar business of Cuba.

Early in 1902 it bought two large factories at Havana, combining them under the name of H. de Cabanas y Carbajal (Incorporated). This company issued $1,500,000 of stock, all of which was held by the American Cigar Company. Shortly afterwards, on May 28, 1902, the Havana Tobacco Company was organized. It took over the Stocks of

Henry Clay and Bock & Co., and the Havana Commercial Company, two combinations which had been formed by independent interests some time before, and also that of the Cabanas y Carbajal Company. The new corporation issued no less than $30,000,000 of common stock and $5,000,000 of preferred, together with $7,500,000 of bonds. The American Cigar Company received for the $1,500,000 of Cabanas y Carbajal stock $20,000,000 of common stock of the Havana Tobacco Company and $2,625,000 of its bonds. The common stock had little value, except for purposed of control, and has never paid a dividend. The Havana Tobacco Company from the outset controlled a large proportion of the manufacture of cigars in Cuba.

The American Cigar Company also turned its attention to the manufacture of Stogies, a cheap form of cigar. A combination called the United States Cigar Company had already been made by leading stogie manufacturers, independently of the American Cigar Company. In 1903 the American Stogie Company was organized, issuing $976,000 of preferred stock and $10,879,000 of common stock It took over the assets of the earlier combination, giving for them $976,000 in preferred stock and about $2,500,000 in common stock. The majority of the common stock, however, was given to the American Cigar Company. The company was enormously overcapitalized, and this stock had little value except for purposes of control, and has never paid a dividend.

Merger in the American Tobacco Company, 1904.

The control of the Tobacco combination continued to be exercised through the Consolidated Tobacco Company until October 19, 1904. At that time the Consolidated and its two subsidiary companies, the American and the Continental, were all merged into one company called the American Tobacco Company. This merger was prompted in part by the adverse decision of the Supreme Court of the United States in the Northern Securities case. The Consolidated Tobacco Company was purely a stockholding company, somewhat analogous to the Northern Securities Company. The merger further fortified the dominant position of the men already in control of the Tobacco combination. It also served to simplify the organization and the securities of the combination.

The merger was accomplished by giving the securities of the reorganized American Tobacco Company in exchange for all the securities of the Consolidated, Continental, and old American companies which were in the hands of the public (this term being used to designate all holders except the three big companies themselves), such previous securities being thereupon canceled, and by the direct cancellation of intercompany holdings. The small amount of American and Continental common stock which was in the hands of the public, $242,400, and the stock of the Consolidated Tobacco Company, $40,000,000 were exchanged for an equal amount of common stock of the reorganized American. The preferred stock of the American Tobacco Company, all of which was in the hands of thepublic, and that part of the preferred stock of the Continental Tobacco Company which was in the hands of thepublic, (about two-thirds of the total), were exchanged for 6 per cent bonds of the reorganized American Tobacco Company on such a basis as to make the return to the holder the same as before. The immense amount of Consolidated Tobacco Company bonds, $157,378,200, which had been issued against the common stocks of the American and Continental Companies, was exchanged dollar for dollar, half for preferred stock of the reorganized American bearing 6 per cent dividends and half for its 4 per cent bonds. The result was that

the reorganized American Tobacco Company had outstanding in 1904 $40,242,400 of common stock, $78,689,100 of preferred stock, and $136,360,600 of bonds.

The preferred stock of the new American Tobacco Company was given no voting power for the electionof directors or on ordinary matters. The power of the men who had controlled the Consolidated stock was thus made even more secure under the reorganization than it had been during the existence of the Consolidated Tobacco Company, for at that time the preferred stocks of the American and Continental companies, which were largely in the hands of the outsiders, had a voting power, although these stocks were a minority as compared with the common stock held by the Consolidated.

General Policy of Absorption and Domination

The history of the Tobacco combination thus presented shows plainly that the leading purpose of the men who have controlled it has been to dominate the tobacco industry. They started out by practically monopolizing the cigarette business. With the great profits derived from that source they carried on a strenuous competitive fight in the plug industry, which ultimately forced the leading competing manufacturers into combination with themselves. This secured for the combination a dominant position in the manufacture, not only of plug, but of smoking tobacco. Soon after, the combination in the snuff industry was brought about, and subsequently a combination in the cigar industry. The latter, however, controls only a limited proportion of the business.

The successive combinations which these man have established, except that in the cigar business, at the outset took in the leading manufacturers and secured a very large degree of control over the business. That degree of control, however, has been further extended by the acquisition, either by direct purchase or by securing a controlling stock interest, of a very large number of other competing concerns The total number of formerly separate concerns and combinations which have passed under the control of the Tobacco combination is in the neighborhood of 250. This number includes the concerns which originally entered the several combinations, but such original acquisitions, though in general they were the largest concerns, were much less numerous than the concerns acquired subsequent to the formation of the combinations. It appears to have been the policy in fact to buy up, from time to time, most competitors whose business had become successful.

The effect of these later acquisitions is best seen in the increase in the proportion of the business controlled. In 1900, shortly after the formation of the Continental Tobacco Company, the Tobacco Company controlled about 60 per cent of the production of chewing and smoking tobacco in the United States. In 1906 it controlled 81.8 per cent of the chewing tobacco and 70.6 per cent of the smoking tobacco. Its proportion of the manufacture of snuff increased from 80.2 per cent in 1901, the first full year of the operation of the American Snuff Company, to 96 per cent in 1906.

A significant feature of many of the acquisitions of the combination, particularly during the period from 1902 to 1904, is the fact that they were made secretly and that the American Tobacco Company

interests, as long as possible, concealed their control, continuing to operate the concerns as though independent and often using them as a special instrument for attacking the business of genuine competitors

Aside from concerns engaged in tobacco manufacture, the American Tobacco Company, and to a less extent the other affiliated combinations have, particularly since 1899, acquired control of many concerns engaged in enterprises contributory to tobacco manufacture. Concerns thus brought under the control of the combination include may engaged in the wholesale or retail distribution of tobacco products, several producing leaf tobacco in Cuba and Porto Rico, a number which make packages and materials, other than tobacco, used in tobacco manufacture, several which exploit patents for machinery or manufacture machinery for the use of tobacco factories, and a few which handle by-products, make smokers' supplies, etc. The most important of these contributory enterprises of which the combination has secured control is the manufacture of licorice, which is a very important material in tobacco manufacture. Through the MacAndrews & Forbes Company, which has bought up several competing concerns, the American Tobacco Company interests have substantially a complete monopoly of the licorice business.

Present Organization and Business of the Tobacco Combination

The Four Principal Companies in the Combination.

The history of the Tobacco combination has made it clear that the American Tobacco Company has throughout been the principal factor, and this is still more true since the reorganization of 1904, which united the Consolidated, American, and Continental companies under the new corporation with the old name, American Tobacco Company. There are three other corporations still, however, whose position in the Tobacco combination distinguishes them from the great majority of the subsidiary companies. These are the American Snuff Company, the American Cigar Company, and the British-American Tobacco Company.

The American Tobacco Company not only controls the other three principal companies named, but is itself a great manufacturing concern, and it also directly controls a large number of other subsidiary companies. The field of the American Tobacco Company and these subsidiary companies includes the manufacture of chewing and smoking tobacco, of cigarettes for domestic consumption, and of so-called little cigars, together with enterprises contributory to these branches of tobacco manufacture.

The American Snuff Company, with its subsidiary companies, is exclusively concerned with the manufacture of snuff.

The American Cigar Company, with its subsidiaries, handled the cigar business of the combination, including the manufacture of ordinary cigars, cheroots and stogies in the United States and the manufacture of cigars and cigarettes in Cuba and Porto Rico.

The British-American Tobacco Company is distinguished from the others by being confined to export business and to the manufacture and sale of tobacco in foreign countries.

The American Tobacco Company holds considerably more than a majority of the capital stock of the American Cigar and British-American companies and over 40 per cent of the stock of the American Snuff Company. By reason of the fact that certain large individual

stockholders of the American Tobacco Company are also stockholders in the American Snuff Company, and by reason of the identity of purposes, the American Snuff company may properly be considered as controlled by the American Tobacco Company.

The Subsidiary Companies

Aside from these four principal companies, there are 82 other companies in the Combination which do business in the United States, Porto Rico, and Cuba, besides a considerable number controlled by the British-American Tobacco Company, which do business in other countries. In practically every one of these 82 companies a majority of the stock is held either by one of the four principal companies or by some company subsidiary to them. In a large number of cases the entire stock of these subsidiary companies is thus held. The combination in buying stocks has apparently sought control even more than investment.

The American Tobacco Company itself controls directly or indirectly 47 of these subsidiary companies, aside from controlling the three principal subsidiary combinations. The American Snuff Company, controls 6 other companies, the American Cigar Company 26, and the British-American Tobacco Company 3 (these 3 companies buy leaf and manufacture tobacco in the United States for export); the British-American also controls many subsidiary companies operating in other countries.

Concentration of Control

The American Tobacco Company, therefore, stands in a controlling position over the entire Tobacco combination with its 86 companies operating in the United States, Porto Rico, and Cuba. The control of the American Tobacco Company itself rests in a very few hands. That company had at the end of 1906 a total capitalization of alittle over 235 millions, including bonds, but of this capitalization only about one sixth - namely, the common stock, amounting to a little more over 40 millions - has voting power for the election of directors or for the ordinary management of the business. The great bulk of the common stock is held by members of the directorate of the American Tobacco Company and their intimate associates. The 28 directors and 4 other stockholders together own 77 per cent of this stock. Indeed, the ten largest stockholders, 7 of whom are directors, together hold over 60 per cent, and these 10 alone can, therefore, readily dominate the entire combination. They are J. B. Duke (president of the company) A. N. Brady, O. H. Payne, P. A. B. Widener, Thomas F. Ryan, B. N. Duke, G. B. Schley, the banking and brokerage firm of Moore & Schley (chiefly as agents for clients), and the estates of W. C. Whitney and W. L. Elkins.

Capitalization of the Combination

The American Tobacco Company is authorized to issue $80,000,000 of 6 per cent cumulative preferred stock and $100,000,000 of common stock, but only about two fifths of the latter has been issued. The amount of each class of securities outstanding at the end of 1906 was:

Common stock	$40,242,400
Preferred stock, 6% cumulative	78,689,100
Six per cent gold bonds, due 1914	55,208,350
Four per cent gold bonds, due 1951	61,052,100(1)
Total	$235,191,950

(1) Including $5,010,500 of Consolidated Tobacco Company bonds assumed by the American Tobacco Company.

The total capitalization of all the 86 companies making up the combination in the United States, Porto Rico, and Cuba amounted at the end of 1906 to $450,395,890, consisting of about 130 millions of preferred stock, about 183 millions of common stock, and about 137 millions of bonds. Of this capitalization, however, a large amount is duplicated by reason of the holding of securities in one company by another company in the combination. The total amount thus held is a little over 134 millions (about half a million of which is stock of the American Tobacco Company itself), leaving as the net capitalization in the hands of the public (including the directors and their associates as well as all other holders except companies in the combination) $316,346,821. This latter amount consists of about 103 million of preferred stock, about 79 millions of common stock, and about 133 millions of bonds. Of the 316 millions of securities in the hands of the public, 235 millions, or about three fourths, consist of the issues of the American Tobacco Company itself. The gross outstanding capitalization of all the other companies is $215,203,940, but of this amount more than 60 per cent, or nearly 134 millions, is held by companies in the Combination.

The Policy of Stock Ownership

The extent to which the Tobacco combination has maintained its control through stock ownership in subsidiary companies, instead of through direct ownership of all plants and other assets, shows that this method of control must possess certain special advantages. This policy of stock ownership has been particularly conspicuous since 1899.

When this policy of stock acquisition was first inaugurated, it was the more common practice of the combination to acquire only a controlling interest in the securities of other corporations, leaving a minority in the hands of the former owners. This practice had various apparent advantages. Through it the Combination was able to acquire control over business without a corresponsingly great investment of capital. In some instances it secured stock interests in concerns engaged in contributory enterprises without investment of capital, but merely in return for contracts for the supply of materials or services to the combination. In numerous cases it appeared advantageous to leave a minority of the stock in the hands of the original ownersin order to retain their interest and skill and to take advantage of their personal following among customers. In some cases, moreover, owners of enterprises were unwilling to sell out absolutely, with the consequent result of having either to quit the business or become mere salaried employees, but were willing to transfer a controlling interest to the combination. Even at this time, however, the combination acquired the entire capital stock of certain corporations and retained their separate existence, and recently this has been its prevalent practice. The combination has, in fact, during the past few years, acquired the remaining shares in a considerable number of companies in which it at first held only a controlling interest. Various reasons have led the combination to continue the separate corporate existence of many of the concerns which it thus completely owned. Aside from advantages arising from legal considerations - the avoidance of the necessity of making reports of the business of the parent corporation

in compliance with the laws of certain States, economy with respect to corporation fees and taxes, and the like - the continued existence of such concerns has often been highly desirable on account of the trade value of their names.

Secretly Controlled Companies

The most important motive, however, for the continuance of separate corporate existence in the case of many concerns has been the desire of the combination to keep its control secret. There is a strong feeling among many dealers and consumers against "trusts" in general and the "Tobacco Trust" in particular. Independent manufacturers have extensively taken advantage of this feeling and have advertised their goods as "Independent", "Not made by a Trust" and so forth. The attitude of the American Tobacco Company and its openly affiliated concerns in refusing to deal with labor organizations has also caused hostility among union laboring men, many of whom insist on buying "union-lable"goods. Many independent manufacturers have availed themselves of the union-label sentiment to build up a trade.

In order to overcome the effects of the antitrust sentiment and the union-lable sentiment, and even to take advantage of them, the Tobacco combination, particularly during 1903 and 1904, secretly acquired a controlling interest in numerous concerns which had been catering to customers who held those sentiments. Such concerns continued to operate under their former management and kept up a pretense of independence and of hostility to the combination. Those which employed union labor continued to do so and advertised the union label. These secretly controlled concerns were, until the facts were disclosed by the Government, a powerful engine of warfare against the genuine independents and were looked upon by the latter as their worst enemy.

Among the concerns of which control was thus secretly acquired and for a greater or less period secretly maintained by the American and Continental tobacco companies are the following:

(21 companies by name omitted)

The American Tobacco Company Group

The American Tobacco Company itself, as already stated, is a great manufacturing concern, and it also controls directly a large number of subsidiary companies engaged in the same branches of tobacco manufacture or in contributory enterprises, which, with itself, make up what may be called the American Tobacco Company group. The American Tobacco Company has reserved to itself and to these subsidiary companies the manufacture of cigarettes for domestic consumption (including "little cigars") and of plug tobacco, smoking tobacco, fine-cut tobacco, and scrap tobacco. The company has concentrated itsown direct manufacture of these tobacco products for the most part in a limited number of very large plants, having closed most of the plants which have from time to time been acquired.

To a considerable degree the company has pursued the policy of specializing individual large plants on a single class of products. There has also been some concentration and specialization of manufacture in the hands of leading subsidiary companies in this group, but in other cases subsidiary corporations have been continued, even tho their output was small and considerably diversified, this policy being chiefly pursued in the case of the secretly controlled concerns.

The cigarette and little-cigar business of the American Tobacco Company proper is conducted in nine plants; but two of these, at New York and Richmond, respectively, make nearly its entire direct output of cigarettes; and two others, at Baltimore and Danville, Va., make much the greater part of its output of little cigars. The cigarettes made in plants directly owned by the company are chiefly made from domestic leaf. The company had during 1906 five subsidiary cigarette companies, the greater part of whose aggregate output consists of Turkish cigarettes.

Of the output of plug and twist tobacco by the American Tobacco group in 1906, about 104,000,000 pounds were produced in plants directly owned by the parent company, and about 40,000,000 pounds in plants of subsidiary companies. The 104,000,000 pounds were produced in only six plants, and seven eighths of this amount was made in two of them, the Liggett & Myers-Drummond branch, at St. Louis, and the National Tobacco Works, at Louisville. There are ten subsidiary companies manufacturing plug and twist.

The output of fine-cut tobacco controlled by the American Tobacco Company is all produced in factories which also make smoking tobacco, so that the two products may be considered together. Of the total output of about 115,000,000 pounds of these products by the American Tobacco Company group in 1906, nearly one half was made in plants of subsidiary companies. The American Tobacco Company owns directly nine plants which manufacture smoking tobacco, of which five make their product only. The most important of these plants is at Durham, N. C.; it produced nearly 18,000,000 pounds of granulated smoking tobacco, principally Duke's Mixture, in 1906. The other directly owned plants making smoking tobacco are located at Baltimore, Louisville, St. Louis, Chicago, Richmond, New York, and New Orleans. Seventeen of the subsidiary companies make more or less smoking tobacco and fine cut, but only five are of much importance. The largest output is that of P. Lorillard Company, of Jersey City. The nest largest is that of the Blackwell's Durham Tobacco Company, of Durham, N.C.

The American Tobacco Company group also has a large output of scrap tobacco, which, although classed by the Bureau of Internal Revenue with smoking tobacco, is chiefly used for chewing. By far the largest part of the output of this product, however, is in the hands of four subsidiary companies, the most important of which are the Luhrman & Wilbern Tobacco Company, of Middletown, Ohio, and the Day and Night Tobacco Company, of Cincinnati. The control of the latter was at first kept secret, as was that of the Pinkerton Tobacco Company, another manufacturer of scrap. Spaulding & Merrick also make scrap.

The importance of the American Tobacco Company and its directly subsidiary companies as manufacturers of tobacco products may be judged from their total consumption of leaf tobacco, which amounted to nearly 281,000,000 pounds in 1906. The extent to which the Combination has concentrated its manufacture in large plants is seen in the fact that one plant, the Liggett & Myers-Drummond branch at St. Louis, consumed nearly one fifth of this leaf tobacco, while six plants together consumed over 55 per cent of the total, and the twelve largest over 75 per cent. The American Tobacco Company has an extensive leaf department for the purchase, drying, stemming, and storage of leaf tobacco.

The American Tobacco Company is also engaged in numerous contributory enterprises connected with tobacco manufacture. To some extent certain of these, such as the manufacture of packages, are conducted in the same plants which manufacture tobacco, but for the most part they are carried on in other plants and by seaprate subsidiary companies.

The greatest of these contributing concerns is the MacAndrews & Forbes Company, which has an almost complete monopoly of the manufacture of licorice paste in the United States. Licorice, next to leaf tobacco, is the most important raw material used in tobacco manufacture. and more than nine tenths of the licorice made in the country is used in tobacco. The MacAndrews & Forbes Company has absorbed several other formerly independent concerns, and now not only furnished licorice to the American Tobacco Company and its affiliated concerns, but also to most independent tobacco manufacturers. The prices which it charged to the latter were the subject of much complaint, and the company, along with the J. S. Young Company, which it afterwards absorbed, was convicted in the Federal courts of a violation of the Sherman anti-trust act.

Other important contributory concerns controlled by the American Tobacco Company are the Conley Foil Company and the Johnston Tin Foil and Metal Company, makers of tinfoil, the Golden Belt Manufacturing Company, maker of cotton bags for packing tobacco; the Mengel Box Company, and its two subsidiary concerns, makers of wooden boxes; the American Machine and Foundry Company, the New Jersey Machine Company, and the International Cigar Machinery Company, all of which make machinery or hold and develop patents therefor; the Kentucky Tobacco Product Company, which makes nicotine extracts of various kinds out of tobacco stems, the principal by-product of tobacco manufacture; and the Manhattan Brier Pipe Company.

The American Tobacco Company is also interested in a number of distributing companies, most of which, however, sell not only its own products, but also cigars and the products of other branches of the combination, as well as of independent concerns. The most important of these concerns is the United Cigar Stores Company of New Jersey, which has several subsidiaries. This company and most of its subsidiaries operate chains of retail stores, the aggregate number being about four hundred.

Other distributing concerns in which the American Tobacco Company has a stock interest are the Crescent Cigar and Tobacco Company, of New Orleans, the Acker, Merrall & Condit, wholesale and retail grocers of New York; about one fifth of the stock of the latter company is held by the American. The American Tobacco Company also controls the Thomas Cusack Company, a bill-posting concern, and the Florodora Tag Company, which is at present inactive, but which formerly did an immense business in the distribution of premiums.

Aside from distributing concerns controlled by stock ownership, the American Tobacco Companny and its affiliated combinations have very close relations with many other distributing concerns. One method of establishing such relations is by granting special discounts to large jobbing concerns. The smoking-tobacco department of the American Tobacco Company alone paid in 1906 and in 1907 special commissions to more than 250 jobbers. Such special commissions are not at the present time in any case conditional upon exclusive distribution of the American Tobacco Company's products, nor, except in cigars, does any jobber have the exclusive right to the wholesale distribution of the products

of the combination in any particular territory. To the Metropolitan Tobacco Company, however, the American Tobacco Company has given exclusive control of the wholesale distribution of its products in Greater New York. Subsidiary companies of the Metropolitan control a large part of New Jersey in the same way. The National Cigar Stands Company, which operates cigar stands in a very large number of drug stores scattered throughout the United States, as well as some fifty or sixty leading jobbing concerns, has credits and loans of considerable amount extended to it by the combination. In some cases these credits are of such amount as to give the combination substantial control of the business.

The Snuff Group

The American Snuff Company and its subsidiary companies are engaged exclusively in the snuff business. The parent company has outstanding $12,000,000 of preferred stock and $11,001,700 of common stock. The American Tobacco Company, together with the P. Lorillard Company, which it controls, owns $2,366,400 of the preferred and $7,500,800 of the common stock, or 42.9 per cent of the entire issue of both combined. Although this is a minority of the stock, the American Snuff Company is as essentially a part of the one great Tobacco combination as the American Tobacco Company itself.

The American Snuff Company has closed up most of the plants which from time to time it has acquired from formerly independent concerns. In 1906 it operated directly four plants and controlled six subsiduary companies; the latter, however, were virtually little more than branches, the entire stock of each being held by the parent company. The directly owned plants produced over three fifths of the output controlled by the combination and the subsidiary companies all of the remainder, except 24,391 pounds made on royalty by the Irby branch of the American Tobacco Company. The directly owned plants are, in the order of their importance, the Helmetta (New Jersey) branch, the Baltimore branch, the Nashville branch, and the Clarksville (Tenn.) branch. The most important subsidiary companies in 1906 were W. E. Garrett & Sons, of Yorklyn, Del., and Weyman & Bro. of Chicago. These companies have since transferred their property directly to the American Snuff Company. W. E. Garrett & Sons in 1906 produced more snuff than any branch directly owned by the American Snuff Company except that at Helmetta, N. J. The next largest of the subsidiary concerns is the Standard Snuff Company, Skinner & Co. and H. Bolander (Incorporated) - are very small concerns.

The Cigar Group

The business of the American Cigar Company and its subsidiary manufacturing concerns in the United States is exclusively the production of cigars, including cheroots and stogies. In Cuba and Porto Rico this group of companies makes both cigars and cigarettes.

The American Cigar Company has outstanding $10,000,000 of preferred stock, $10,000,000 of common stock, and $10,000,000 of ten-year gold notes. The American Tobacco Company holds $8,970,000 of the preferred stock (besides $500,000 held by the $8,970,000 of the preferred stock (besides $500,000 held by the American Snuff Company) and $7,725,100 of the common stock.

The output of plants operated directly by the American Cigar Company is confined almost exclusively to ordinary cigars made from domestic leaf and to cheroots. It had 29 plants in operation in 1906, and their aggregate output was about five times as great as the output of cigars by all its subsidiary companies operating in the United States. Most of these 29 plants have been acquired from formerly independent concerns, and many others so acquired have been closed. The two plants at Jersey City and Richmond are the largest in the country, making about 190 million cigars each in 1906.

The American Cigar Company holds the entire capital stock of the Havana-American Company, which is the most important manufacturer of cigars made from Cuban leaf in the United States. This company operates 10 factories, most of them at Key West and Tampa, Fla. The American Cigar Company also holds about three fifths of the stock of the American Stogie Company, a heavily overcapitalized combination of stogie manufacturers (common stock $10,879,000, preferred $976,000). This is a New Jersey corporation, but most of its business has been carried on through a subsidiary Pennsylvania company of the same name (changed in 1907 to Union American Cigar Company), which has recently announced its intention of manufacturing ordinary cigars as well as stogies.

The American Cigar Company controls its important business of manufacturing cigars and cigarettes in Cuba through the Havana Tobacco Company, a greatly overcapitalized concern (common stock $30,000,000, preferred $5,000,000, bonds $7,500,000), nearly half of whose stock is held by the American Cigar Company. This company controls several others--Henry Clay and Bock & Co., Havana Cigar and Tobacco Factories, Havana Commercial Company, H. de Cabanas y Carbajal, and J. S. Murias y Ca.--which together have a considerable proportion of the manufacture of cigars and cigarettes in Cuba.

The American Cigar Company further controls, jointly with the American Tobacco Company, the Porto Rican-American Tobacco Company (capital stock $1,999,000, scrip $72,538), which is much the largest manufacturer of cigars and cigarettes in Porto Rico. It is likewise interested either directly or indirectly in several companies which grow or handle tobacco leaf in Cuba and Porto Rico.

The American Cigar Company has also controlling stock interests in a dozen or more wholesale or retail distributing companies, most of which handle other tobacco products as well as cigars.

British-American Tobacco Company

The British-American Tobacco Company, which is the representative of the Tobacco Combination in export and foreign trade, is an English corporation. It has outstanding $7,290,000 of preferred stock and $18,079,302 of common stock. The American Tobacco Company holds substantially two thirds of each class, namely, $4,860,000 of preferred and $11,897,255 of common. Practically all the rest of the stock is held by the Imperial Tobacco Company, the great British combination.

The principal business of the British-American Tobacco Company in the United States is the purchase and preparation of leaf tobacco for shipment to its affiliated concerns abroad, and the

manufacture of cigarettes for export. Its cigarette manufacture is chiefly conducted in one plant at Durham, N. C., but it has also a cigarette plant at Petersburg, Va. The company also controls three subsidiary concerns doing business in the United States.

DEVELOPMENT OF THE COMBINATION'S CONTROL OF THE TOBACCO INDUSTRY.

The Combination's Proportion of the Business, 1906

The Tobacco Combination, including the American Tobacco Company and the affiliated combinations and subsidiary companies, occupies a strikingly dominant position in the manufacture of all forms of tobacco, except cigars, in the United States. The table on this page shows its proportion of the output during 1906.

While the Combination manufactures less than one sixth of the cigars made in the United States, it has substantially four fifths of the combined business in other classes of the tobacco

THE COMBINATION'S PROPORTION OF THE OUTPUT OF TOBACCO PRODUCTS, 1906.

Product	Output of United States	The Combination		Independent Concerns	
		Output	Per cent of total	Output	Per cent of total
	Number	Number		Number	
Cigarettes. . . .	6,437,692,637	5,309,128,300	82.5	1,128,564,337	17.5
Little cigars . .	989,751,253	804,433,750	81.3	185,317,503	18.7
Cigars	7,147,548,312	1,052,805,858	14.7	6,094,742,454	85.3
	Pounds	Pounds		Pounds	
Plug and twist .	182,343,364	149,119,539	81.8	33,223,825	18.2
Smoking	175,672,171	124,032,420	70.6	51,639,751	29.4
Fine cut	12,742,345	10,310,960	80.9	2,431,385	19.1
Snuff	23,518,549	22,576,722	96.0	941,827	4.0
Total manufactured tobacco and snuff	394,276,429	306,039,641	77.6	88,236,788	22.4

products, its proportion ranging from 70.6 per cent of the total output in the case of smoking tobacco to 96 per cent in the case of snuff. Combining those products which are measured in pounds--namely, chewing tobacco, smoking tobacco, fine-cut tobacco, and snuff--the Combination's proportion of the output is 77.6 per cent. The Combination has, therefore, very strong monopolistic power.

With the exception of cigarettes, very nearly the entire quantity of manufactured tobacco products made in the United States is consumed there, so that the Combination's proportion of the domestic trade in these products corresponds substantially to its proportion of the entire output. In the case of cigarettes approximately one third of the number made is exported. The Combination has practically the entire export trade, from which it follows that its proportion of the production for domestic consumption is somewhat less than appears in the above table, being 74.5 per cent in 1906.

Conclusion

These facts (ten pages of detail omitted.) emphasize the conclusion already drawn from the history of the organization of the Tobacco Combination, that its primary object has been to secure a dominant position in the tobacco business of the United States with the result that it has a nearly complete control of it, save only in the manufacture of cigars.

The combination has superior advantages over competitors, from the great size of its plants and from the control of more efficient machinery. These advantages, however, have not been sufficient to enable it, while charging high prices for the greater part of its product, to increase its degree of control, particularly in view of the fact that many consumers prefer to patronize independent concerns. Despite enormous expenditures for advertising and in "schemes" and despite frequent price cutting by means of its so-called "fighting brands" and its bogus independent concerns, there has been, in several branches of the industry, a constant tendency for competitors to gain business more rapidly than the combination and thus to reduce its proportion of the output. This tendency has been overcome only by continued buying up of competitive concerns. Many weaker concerns have been virtually driven out of business or forced to sell out to the combination, either by reason of the direct competition of the latter, or as an indirect result of the vigorous competition between the combination and larger independent concerns. In the case of the larger and more powerful concerns which it acquired, however, the combination has usually secured control only by paying a high price. The immense profits of the combination have enabled it to keep up this policy.

HISTORY OF THE FOREIGN INTERESTS OF THE TOBACCO COMBINATION

Early History

From the time of the original formation of the American Tobacco Company in 1890 it had a considerable foreign business. For a few years this business consisted chiefly of cigarettes, and washandled directly by the American Tobacco Company itself. As early as 1894, however, several subsidiary companies had been organized in Australia and in the following year several Canadian concerns were combined in the American Tobacco Company of Canada. No other important subsidiary corporations were organized or acquired in foreign countries until 1899. In that year, as already related, the American Tobacco Company acquired a controlling interest in a large cigarette-manufacturing business in Japan. Two years later the interests of the company in foreign corporations were extended by the purchase of two thirds of the capital stock of the George A. Jasmatzi Company (Limited), of Dresden, Germany.

No exact figures are available as to the output of the above-mentioned foreign concerns, but in 1901 President Duke estimated the output of the Canadian concerns at about 100,000,000 cigarettes annually and that of the Australian factories at about 200,00,000 a year. He said at the same time that the daily production of the Japanese company was 8,000,000 cigarettes. It was reported in the Commercial and Financial Chronicle that the daily production of the German company was 3,000,000 cigarettes, which would amount to over 900,000,000 annually.

In addition to the foreign business handled through the ownership of a controlling interest in these foreign factories, the American

Tobacco Company was the principal exporter of cigarettes from the United States. Its exports during its first year in business amounted to only 262,681,500 cigarettes, but they increased steadily and rapidly until the year 1898, when they amounted to 1,215,632,000. In 1890 this export business was a little over one tenth of the entire cigarette output of the American Tobacco Company, and in 1898 very nearly one third. During this period the exports of cigarettes from the United States by all other manufacturers combined were much less than those of the American.

COMPETITIVE CAMPAIGN OF THE AMERICAN TOBACCO COMPANY IN ENGLAND

Declining Profits on Exports to England.--In addition to the subsidiary manufacturing corporations referred to above, companies and agencies which operated simply as selling or distributing concerns were established in various countries. One of the most important of these was the London depot of the American Tobacco Company. In 1898 the sales of this depot amounted to $916,720.93, but as the total expenses of the depot, including gold of goods, were $916,732.07 the enterprise was by no means as satisfactory as might have been desired. From that year the sales of the depot declined in amount, and by 1900, the last full year of its operation, they were only $591,897.36. The cost of goods and the expenditures of the agency had not declined in like proportion, for they amounted to $646,835.99, showing a loss on the year's business of over $50,000. The American Tobacco Company ascribed this unsatisfactory condition of its English business to the duties on leaf and manufactured tobacco going into England, which were so arranged as to give a considerable degree of protection to the domestic manufacturer. In view of this condition the officers and managers of the American Tobacco Company decided that it was necessary to acquire or establish a manufacturing plant or plants in England if their business was to meet with success in that country.

Purchase of Ogden's (Limited).--The formation of the Consolidated Tobacco Company in June, 1901, provided the necessary means for carrying out the plans of the men at the head of the Tobacco combination in regard to the acquisition of English plants. The entire $30,000,000 capital stock issued by the Consolidated Tobacco Company was paid in in cash and was available in the form of loans for any of the enterprises undertaken by the American and Continental tobacco companies or the American Cigar Company. Shortly after this large fund of new capital became available President James D. Duke, together with W. R. Harris and C. C. Dula, who were officers of the Consolidated and its affiliated companies, went to England for the purpose of carrying out the plan for establishing a large English manufacturing business. They at once began negotiations for the purchase of Ogden's (Limited), one of the most important tobacco manufacturing concerns in Great Britain. Before the end of September, 1901, they had acquired substantially the whole outstanding stock of the company. The following statement shows the number of the outstanding shares and the percentage of the total acquired by the American Tobacco Company:

	Total Shares of Company Issued	Acquired by American Tobacco Co.	
		Number	Per cent of total issue
Debenture shares	60,000	59,600	99.3
Preference shares	200,000	199,250	99.6
Ordinary shares	350,000	335,200	95.8

The total cost of the shares acquired was $5,347,888.87

About this time the British Tobacco Company was incorporated under the English law by the officers of the American Tobacco Company, and it was their intention that it should become a holding company for the interests of the Tobacco Combination in Great Britain. As a matter of fact, however, the shares in Ogden's (Limited), were taken over directly by the American Tobacco Company, and on December 31, 1901, that company still held the nominal outstanding stock of the British Tobacco Company, amounting to only £15. Subsequent events prevented the development of this holding company.

Organization of the Imperial Tobacco Company.--The purchase of Ogden's (Limited) caused immediate alarm among the British manufacturers of cigarettes and tobaccos. They feared the power of the American Tobacco Company, with its enormous business and resources. The American scarcely had time to show its policy in the management of the Ogden's concern before the other leading manufacturers of tobacco in Great Britain had formed a combination to resist this dangerous rival.

Thirteen of the largest manufacturers in Great Britain combined to form the Imperial Tobacco Company (of Great Britain and Ireland)(Limited). This company, which was registered December 10, amalgamated the tobacco business of the following firms: W. D. & H. O. Wills, Edwards, Ringer & Bigg, and Franklyn, Davey & Co., of Bristol; Lambert & Butler, Hihnett's Tobacco Company, and Adkin & Sons, of London; John Player and Sons, Nittingham; Hignett Bros & Co., William Clarke & Son, and Richmond Cavendish Company, of Liverpool, and Stephen Mitchell & Son, F & J. Smith, and D. & J. MacDonald of Glasgow. Preliminary Agreements for the formation of this combination, which had been made on October 3 and 10, 1901, were ratified by the company on February 3, 1902. The authorized capital was £15,000,000, with additional debenture stock, limited in amount to 50 per cent of the cumulative preference shares for the time being issued, the total limit being £2,500,000. Thus the authorized share and loan capital together was £17,500,000. This was divided as follows:

4¼ per cent debenture stock	£2,500,000
5½ per cent cumulative preference shares... . .	5,000,000
6 per cent noncumulative preferred ordinary shares	5,000,000
Deferred ordinary shares	5,000,000
Total capital	£17,500,000

The total capital stock, the amount of each kind of stock issued, and the amounts issued to the vendors and to the public are shown in the table below:

	To Vendors	To the Public	Total Issue	Unissued
Debenture stock	£500,000	£1,000,000	£1,500,000	£1,000,000
Cumulative preference shares	1,500,000	3,000,000	4,500,000	500,000
Preferred ordinary shares	4,259,049	---	4,259,049	740,951
Deferred ordinary shares.	4,259,048	---	4,259,048	740,952
	£10,518,097		£14,518,097	
Total		£4,000,000		£2,981,903

The first column shows that the stock taken by the members of the various firms which combined to form the Imperial Tobacco Company amounted to £10,518,097. They also received £1,438,925 in cash.

The principal items of the assets of the Imperial Tobacco Company, as set forth in its first balance sheet, were:

Land, buildings, plant, machinery, stock, etc., obtained from combining concerns	£3,438,925
Cash, obtained as working capital by sale of stock to the public (in addition to cash paid venders)	2,561,075
Good will	8,518,097
Total	£14,518,097

The average annual profit of the companies combined during the preceding three years was certified to have been £1,062,922, after allowing for depreciation. This, after paying interest on debenture stock and dividends on cumulative preference shares, would equal nearly 9 per cent on both issues of ordinary stock.

An agreement was made by the Imperial Tobacco Company early in its career (January, 1902) with Salmon & Gluckstein (Limited), a corporation manufacturing tobacco and also controlling a number of retail stores in England. Under this agreement the existing £450,000 of the ordinary shares in the latter company were to be converted into 10 per cent preference shares, the dividend to be guaranteed by the Imperial Tobacco Company, and £100,000 in ordinary shares were to be created and issued and to be subscribed for by the Imperial Tobacco Company. This step assured the Imperial Tobacco Company the coöperation of the largest English retail house in its campaign against the American interests.

The Imperial Tobacco Company immediately began a campaign of active competition to check and frustrate the plans of the American Tobacco Company for strengthening its foothold in Great Britain. In March, 1902, the Imperial offered large bonuses to customers who would undertake not to sell American goods for a term of years. The American Tobacco Company, through the Ogden's Company, met this by offering to its British customers, for the next four years, its whole net profits on British business, and £200,000 a year besides. The offer was as follows:

Commencing April 2, 1902, we will for the next four years distribute to such of our customers in the United Kingdom as purchase direct from us our entire net profits on the goods sold by us in the United Kingdom. In addition to the above, we will, commencing April 2, 1902, for the next four years, distribute to such of our customers in the United Kingdom as purchase direct from us the sum of £200,000 per year. The distribution of net profits will be made

as soon after April 2, 1903, and annually thereafter, as the accounts can be audited, and will be in proportion to the purchases made during the year. The distribution as to the £200,000 per year will be made every three months, the first distribution to take place as soon after July 2, 1903, as accounts can be audited, and will be in proportion to the purchases during the three-months period. To participate in this offer we do not ask you to boycott the goods of any other manufacturer.

This offer had a marked effect in opening the British trade to American competition. As a countermove the Imperial Tobacco Company threatened to invade the American market, and in the summer of 1902 it was reported to be selecting sites for factories in this country. Before any definite steps were taken, however, to carry out this plan, an agreement was arrived at between the two great rival corporations, which completely changed their position toward each other.

AGREEMENT WITH THE IMPERIAL TOBACCO COMPANY

The agreement between the American Tobacco Company interests and the Imperial Tobacco Company was made on September 27, 1902, about a year after the purchase of Ogden's by the American and about seven months after the complete establishment of the Imperial. The agreement was embodied in two documents. The first related to the trade in the United Kingdom and the United States, providing for the transfer of Ogden's to the Imperial and for division of territory between the Imperial and the American. The second provided for the establishment of a new corporation, to be jointly controlled by the American and the Imperial, which was to do business in countries outside of the United Kingdom and the United States.

The former agreement was executed by Ogden's (Limited), the American Tobacco Company, Continental Tobacco Company, American Cigar Company, Consolidated Tobacco Company, and the British Tobacco Company (Limited), on the one hand, and the Imperial Tobacco Company on the other. By it, Ogden's (Limited) agreement to convey to the Imperial company its whole undertaking clear of incumbrances, except its export business, and except its cash and book accounts. The plant, including land and buildings, machinery, tools, and live stock, was to be taken at the valuation at which it then stood on the books of the Ogden's Company; stock in trade and materials were to be taken at cost; and the Ogden's Company was to receive £1,500,000 for its good will, patents, and trade-marks in ordinary shares, half preferred (6 per cent noncumulative) and half deferred, of the Imperial company. For the tangible assets one third was to be paid in preference shares ($5\frac{1}{2}$ cumulative) of the Imperial, one third in its debenture stock ($4\frac{1}{4}$ per cent) and one third in cash; but if the one third should exceed £300,000, the Imperial company was not required to pay more than that amount in preference shares, but might pay half the excess in additional debenture stock and half in additional cash. Indirectly these various payments came chiefly to the American Tobacco Company as the chief holder of the Ogden's stock.

The Imperial Tobacco Company agreed not to engage in the tobacco business in the United States, unless through or in connection with the American company and its allies, except that it retained the right to buy and treat tobacco leaf in the United States for the purposes of its business in the United Kingdom. All

the companies affiliated with the American Tobacco Company, parties to the agreement, bound themselves in like manner not to carry on the tobacco business in the United Kingdom, and they added the following:

The said covenanting parties will procure the following directors of some or one of them, namely, James Buchanan Duke, Benjamin Newton Duke, Thomas Fortune Ryan, John Blackwell Cobb, Williamson Whitehead Fuller, William Rees Harris, Percival Smith Hill, and Caleb Cushing Dula, and will respectively use their best endeavors to procure such other directors as shall be required by the Imperial company to enter into a covenant with the Imperial company similar to that referred to in the preceding part of this clause.

By a parallel clause, certain directors of the Imperial Company were excluded from the tobacco business in the United States.

Neither the Imperial company nor Salmon & Gluckstein (Limited) was to "sell or consign any tobacco products to any person, firm, or company within the United States except the American company or persons or companies designated by it"; and the several American companies were not to "sell or consign any tobacco products to any person, firm, or company in the United Kingdom except the Imperial company or persons or companies designated by it." Goods sold by one company to another under this clause were to be paid for at cost plus 10 per cent. The Imperial company was to be appointed sole agent within the United Kingdom for Havana and Porto Rican cigars and cigarettes controlled by the American companies, and the Imperial company was not to handle any other Havana or Porto Rican cigars or cigarettes; and on these goods the Imperial company was to have a commission of 7½ per cent. The Imperial company was to use its best endeavors to promote the sale of such cigars and cigarettes in the United Kingdom, and the American company might not call its endeavors in question so long as it maintained a sale of the Havana cigars and cigarettes included in the agency equal to not less than 72 per cent of the total annual importations into the United Kingdom, duty paid, of cigars and cigarettes made in Cuba, the percentage being based on an average of three years. This percentage was fixed on the assumption that the American companies "control or will shortly control not less than 80 per cent of the aforesaid annual importation." This part of the agreement was subsequently modified.

As a means of maintaining the harmony of interests between the British and American concerns, it was provided that the allottees of the £1,500,000 in ordinary shares of the Imperial company, issued in payment for the good will and trade-marks of Ogden's (Limited)--that is, the American Tobacco Company interests--should not "sell or transfer more than 10 per cent of the shares within the period of five years from the date of their allotment, if and so long as the present directors of the Imperial company, or some of them, shall hold not less than £3,000,000 in ordinary shares of the Imperial company."

This agreement for exclusive territory is still in full effect and is strictly observed.

Present Capitalization and Business of the Imperial Tobacco Company.--At the time when the Ogden's purchase was made by the Imperial, in 1902, the Imperial increased its authorized capital from £15,000,000 to £18,000,000 namely, £6,000,000 in preference shares, £6,000,000, in preferred ordinary shares, and £6,000,000 in deferred

ordinary shares. By no means all this stock, however, was issued at the time or has since been issued. At the beginning of 1907 the outstanding capital stock of the Imperial, together with its issue of debentures, was as follows:

Preference shares	£ 4,959,249
Preferred ordinary shares	5,260,469
Deferred ordinary shares	5,270,436
Debentures	2,065,011
Total	£17,555,165

It will be observed that the compromise agreement above described specifically reserved to the Imperial Tobacco Company the right to buy and treat leaf tobacco in the United States for the purpose of its business, though it was prohibited from manufacturing finished tobacco products in this country. The Imperial accordingly maintains its own leaf-buying organization in the United States, most of itw raw material coming from this country. It has incorporated this organization under the name of the Imperial Tobacco Company, of Kentucky. It has established its own stemmeries throughout the tobacco districts of Virginia, North Carolina, Kentucky, and Tennessee.

One result of the compromise with the British interests is that several well-known brands of English tobacco which were formerly made only in Great Britain are now made also in the United States to supply the trade here, and thus save the import duty of 55 cents per pound. They bear the same name as before and have the same appearance in every respect, but in small type the packages indicate the fact that the product is made by the American Tobacco Company in this country. There is of course also some English tobacco made by the Imperial in England, which is sold through the American Tobacco Company or its subsidiaries in the United States.

PROFITS OF THE AMERICAN THROUGH THE BRITISH CAMPAIGN

Aside from any advantages which the American Tobacco Company interests secured in the second part of the agreement--that is, in the establishment of the British-American Tobacco Company, as described below--the transfer of Ogden's to the Imperial represented a very considerable profit to the American. The American had paid for its interests in Ogden's (Limited) $5,347,888.87. Aside from receiving about $1,570,000, or approximately their original cost, for its holdings of Ogden's debentures and preference shares, the American Tobacco Company became a large holder of ordinary shares of the Imperial through the transfer of the English business of Ogden's to the Imperial. As already stated, £1,500,000, or nearly $7,500,000, was paid by the Imperial for the good will of Ogden's Limited). Most of this came to the American Tobacco Company as the principal stockholder of Ogden's. The payment was made in the form of 750,000 £1 deferred ordinary shares and 750,000 £1 preferred ordinary shares of the Imperial. Of this stock, 10 per cent was issued to the American Tobacco Company direct, representing compensation to it for the value of its own brands which had been transferred to Ogden's and by it transferred to the Imperial. The remaining 675,000 shares of each class were apportioned among the holders of the ordinary shares of Ogden's (Limited); the American Tobacco Company and its affiliated companies, which held £335,200 out of £350,000 of such ordinary shares, consequently received £646,457 of each class of the Imperial shares for its proportion. The receipts of the American

Tobacco Company for its own brands and business and for its interest in Ogden's thus amounted to £721,457 in preferred ordinary stock and an equal amount in deferred ordinary stock, the total par value of these shares in American money being about $7,000,000. This same stock was carried on the books of the American Tobacco Company after the merger in October, 1904. At the end of 1906 it still held £721,457 of the deferred ordinary shares, but its holdings of the preferred ordinary had fallen to £376,721, large blocks having been sold. At the time when the American Tobacco Company held 721,457

shares each of both the deferred and the preferred ordinary stock of the Imperial its proportion of the total issue of such shares was 13.7 per cent, and its proportion of the entire share capitalization about 8 per cent. By December 31, 1906, this proportion had fallen to about 6 per cent.

The Imperial Tobacco Company has proved very successful, and consequently the ordinary shares received by the American Tobacco Company in exchange for the good will of Ogden's have brought a good return. The total profits of the Imperial were approximately £1,100,000 in 1902, £1,260,000 in 1903, £1,450,000 in 1904, £1,700,000 in 1905, and £1,790,000 in 1906. The deferred ordinary shares, which correspond to common stock, received a dividend of 4 per cent in 1903, 6 per cent in 1904, 8 per cent in 1905, and 10 per cent in 1906. It would appear, therefore, that the securities of the Imperial obtained by the American must be considered to have been worth fully their par value.

The above computation shows over $8,500,000 received by the American Tobacco Company in payment on its interest in Ogden's (Limited). While this is about $3,000,000 in excess of the amount the American paid for Ogden's, it also apparently received shares of the British-American for the good will of the export business of Ogden's. As the accounts of the American Tobacco Company combine these shares with those received for its own export business, the exact amount of either payment has not been ascertained.

Although this transaction was financially profitable to the American Tobacco Company interests, there is little doubt that their campaign in Great Britain fell short in results of what had been anticipated. The American Tobacco men had apparently aspired to substantial domination in the British market. The actual result was the formation of a powerful combination in Great Britain in which the American interests held only a small proportion of the stock.

The agreement, on the other hand, whereby the control of the foreign business of the Imperial and American was combined under the British-American was exceedingly profitable to the American Tobacco Company. In the four years of complete operation of that concern (1904-1907, inclusive), the American received more than $7,000,000 in dividends, while the foreign trade, including investments, in the preceding four years yielded less than $2,000,000.

HISTORY OF THE BRITISH-AMERICAN TOBACCO COMPANY

As already stated, the second agreement of September 27, 1902, between the Imperial Tobacco Company and the American Tobacco Company interests provided for the organization of a tobacco corporation to do business outside of those territories specifically reserved to the

Imperial Tobacco Company and to the American Tobacco Company and its associated concerns, respectively; that is to say, practically outside of the United Kingdom and of the United States and its non-contiguous territories. This new corporation was known as the British-American Tobacco Company (Limited).

The agreement providing for the establishment of this company was signed by the Imperial Tobacco Company, Ogden's (Limited), the American Tobacco Company, Continental Tobacco Company, American Cigar Company, Consolidated Tobacco Company, and "Williamson Whitehead Fuller and James Inskip, on behalf of a company intended to be formed under the companies' acts, 1862 to 1900, with the name of 'British-American Tobacco Company (Limited).'"

The British-American Company was to buy the export business of the other signatories "and the good will appertaining thereto, to include formulae and recipes of preparation, treatment, and manufacture, as well as license to use patent rights, trade-marks, brands, licenses, and other exclusive rights and privileges, for the purposes of such export business, and shall also include all stock or shares in companies incorporated in countries foreign to the United Kingdom and the United States, . . . including all shares of the American Company in Georg A. Jasmatzi Company (of Dresden), and all shares of the Imperial Company in W. D. & H. W. Wills (Australia) (Limited)." The words "United Kingdom" were defined to mean, for the purposes of the agreement, Great Britain and Ireland and the Isle of Man, and the words "United States" to mean "The United States of America as now constituted, Cuba, Porto Rico, the Hawaiian Islands, and the Philippine Islands." The words "export business" were defined to mean:

The manufacture of and dealing in tobacco and its products in any country or place outside the United Kingdom and the United States, and the manufacture of and dealing in tobacco and its products within the United Kingdom for export to any other country except the United States, and the manufacture of and dealing in tobacco and its products in the United States (except in Cuba, Porto Rico, the Hawaiian Islands, and the Philippine Islands), for the purpose of export to any other country except the United Kingdom, and the manufacture and selling in the United Kingdom and the United States, respectively, of tobacco to be supplied to ships in port for the purposes of ships' stores.

For the whole export business, rights, and shares in other companies, to be thus acquired, the British-American company was to issue £2,820,000 in its ordinary shares. One third of this, or £940,000, was to go to the Imperial company, and two thirds, or £1,880,000, to "the Ogden company, the American company, the Continental company, the Cigar company, and the Consolidated company, or some of them, in such proportions as they shall mutually agree." In addition to the shares thus issued, the Imperial company was to take a further amount of £300,000, and the American companies a further amount of £600,000, in the ordinary stock of the British-American, which they were to pay for in cash. The £2,820,000 stock issued for the "export business" was given for good will and other intangible assets; it did not include the export factories nor stock in trade. These were to be separately paid for in cash (out of the proceeds of the cash stock subscription), the factories and equipment at the values at which they stook on the books of the vendors and the stock in trade and materials at cost.

The British-American company agreed not to engage in "the business of a tobacco manufacturer, or in any dealing in tobacco or its products, except in the manner and within the limits contemplated and authorized by this agreement," and each of the other companies agreed not to engage in export business, as defined in the agreement, except as it might be interested as a member of the British-American company or of a company formed with its concurrence, and also except so far as the American companies might be interested as members of companies or firms engaged in exporting cigars and cigarettes from Cuba, Porto Rico, the Hawaiian Islands, and the Philippine Islands.

In pursuance of this agreement the British-American Tobacco Company was incorporated under the laws of Great Britain. Its authorized capital is £6,000,000, £1,500,000 in 5 per cent cumulative preference shares and £4,500,000 in ordinary shares. Only ordinary shares were at first issued. The amount issued in pursuance of the terms of the agreement, as above set forth, was £3,720,021, which was still the amount of ordinary shares outstanding at the end of 1906. Of this, as provided by the agreement, two thirds went to the American Tobacco Company and its affiliated concerns and the remainder to the Imperial Tobacco Company. At the time of the consolidation of the American Continental, and Consolidated companies, in 1904, the entire amount of ordinary shares of the British-American which had been acquired by them, £2,480,012 ($12,052,858.32), was transferred to the reorganized American Tobacco Company. In 1906 the American Tobacco Company sold 105,333 shares of this stock, its holdings at the end of that year amounting to £2,447,995 ($11,897,255.29).

Some time after the issue of the ordinary shares the entire authorized amount of preference shares, £1,500,000, was issued by the British-American company, precisely two thirds being subscribed by the American Tobacco Company interests and the remainder by the Imperial. The same 1,000,000 shares of preference stock obtained at this time are still held by the American Tobacco Company, the par value in American currency being $4,860,000. These preference shares were paid for in cash and the proceeds used for developing the business of the British-American.

The total issued capital of the British-American at the end of 1906 was, therefore, £5,220,021 ($25,369,302.06), of which nearly two thirds was held by the American Tobacco Company.

The British-American Tobacco Company has very considerably extended the already large export business which was turned over to it by the American and Imperial companies. It manufactures large amounts of tobacco in the United States for export, and it also manufactures some in foreign countries. To a very large extent it acts as a wholesale distributor of its own products and, to some extent, of products purchased from other concerns, particularly from the Imperial and from the American Tobacco Company and its subsidiary concerns. The business of the British-American Tobacco Company is in part carried on in its own name and in part by means of subsidiary companies. Aside from the subsidiary companies in several foreign countries, whose stocks were turned over to the British-American by the American and Imperial interests, it has acquired stocks in a large number of other concerns, both in the United States and foreign countries.

agreed not to engage in "the business in any dealing in tobacco or its [illegible] within the limits contemplated and a agreement," and each of the other companies agreed [illegible] as a member of the [illegible] and also except as for [illegible] with the companies, and also except as for [illegible] companies might be interested as members of companies [illegible] cigars and cigarettes from Cuba, for to [illegible]

[illegible] issuance of this agreement was British-American Tobacco [illegible] incorporated under the laws of Great Britain. The [illegible] [illegible] is £8,000,000, £1,000,000 in 5-per cent cumulative [illegible] [illegible] and £4,500,000 in ordinary shares. Only ordinary [illegible] at first issued. The amount issued in pursuance of the [illegible] agreement, as above set forth, was £3,750,001, which [illegible] the amount of ordinary shares outstanding at the end of 1902. [illegible] provided by the agreement, two thirds went to the American [illegible] Company and the affiliated concerns and the remainder [illegible] Imperial Tobacco Company. At the time of the consolidation [illegible] Continental and Consolidated companies, in [illegible] of ordinary shares of the British-American [illegible]

[illegible] company sold 100,000 shares at [illegible] [illegible] that year amounting to £4,447,998 ($21,687,863.39).

[illegible] after the issue of the ordinary shares [illegible] amount of preference shares, £1,000,000, was issued to [illegible] American Company, [illegible] and the remainder by the [illegible] Tobacco Company interests. [illegible] preference shares [illegible] the same 1,000,000 shares of preference stock [illegible] [illegible] authorized by the [illegible] [illegible] currency being $4,865,000. These preference shares were [illegible] and the proceeds used for developing the business [illegible] British-American.

[illegible] total issued capital of the British-American at the end of [illegible] therefore, £8,880,001 ($43,329,365.03), of which nearly [illegible] was held by the American Tobacco Company.

[illegible] British-American Tobacco Company was very [illegible] the already large export business which was turned over to [illegible] American and Imperial companies. It manufactures large [illegible] tobacco in the United States for export, and it also manufactures [illegible] foreign countries. To a very large extent it [illegible] [illegible] factor of its own products and, to some extent, [illegible] [illegible] from other concerns, particularly from the Imperial [illegible] from the American Company. [illegible] [illegible] companies of the British-American Tobacco Company is in [illegible] and in its own name and in part by means of subsidiary [illegible] [illegible] companies in various foreign [illegible] [illegible] to the British-American by [illegible] [illegible] has acquired control in the United States and foreign [illegible]

PRICES, COSTS, AND PROFITS

The principal facts shown in this report are grouped below under three heads according as they relate to the combination, to the successor companies, or to other companies.

COMBINATION

The combination originated in 1890 with the formation of the American Tobacco Company, which, through the expansion of its business and the affiliation of numerous other concerns, acquired a dominating position in the tobacco industry. This combination was dissolved by judicial decree in 1911.

The salient points brought out in this part of the report relativ to the business of the combination, so far as it was engaged in the manufacture and sale of tobacco in the United States, are as follows:

(1) That the combination from 1902 to 1910 had a monopolistic position in each of the chief branches of the tobacco business, except in cigars, the minimum proportion of the annual output in the several branches ranging fro two thirds to over five sixths of the total output of the country, while in cigars the maximum proportion in any year was only one sixth of the total.

The combination's proportions of the annual output, by branches, from 1902 to 1910 were:

Year	Plug	Smoking	Fine Cut	Snuff	Cigarettes	Little Cigars	Cigars
1902	71.2	66.3	73.7	85.9	84.6	71.8	14.3
1903	76.9	67.1	77.6	89.4	83.9	67.9	16.4
1904	78.2	69.2	80.4	90.6	87.7	79.2	13.9
1905	80.7	68.7	81.7	93.8	84.7	78.3	13.3
1906	81.8	70.6	80.9	96.0	82.5	81.3	14.7
1907	80.5	72.4	81.4	95.7	81.7	90.8	14.5
1908	81.9	73.6	79.2	95.7	81.8	88.7	13.0
1909	83.3	75.3	80.1	96.1	83.6	89.0	13.1
1910	84.9	76.2	79.7	96.5	86.1	91.4	14.4

(2) That for the combination high rates of profit have followed monopolistic control, the greater the degree of control the greater the rate.

Thus, in the plug branch from 1893 to 1898 the combination lost an average of 3 cents per pound of plug tobacco sold. Its output during this period was less than 25 per cent of the total output of the United States. By 1900, however, it had secured 62 per cent of the output and in this year its profit was 3.8 cents per pound, and by 1905 it had secured control of over 80 per cent of the country's output and its profit was nearly 8 cents per pound.

In the smoking branch the combination's control from 1893 to 1898 was less than 25 per cent of the total output of the United States, and its profits averaged about 4 cents per pound. From 1902 to 1910 when the control of the combination was from 66 to 76 per cent its profits were approximately 7 cents per pound.

In the fine-cut branch from 1899 to 1901 the combination's control of the total output was less than 50 per cent. In two of these years it sold its fine-cut product at a loss. On the other hand, from 1902 to 1910 its control was nearly 80 per cent and its profit per pound ranged from 3.9 cents to 7.6 cents.

In the snuff branch the combination had practically a complete control after 1903, and in no other branch were the profits as large or the variations from year to year as small.

In the cigarette branch the combination had practically a complete control from the organization of the American Tobacco Co. in 1890. In this branch the rates of profit were also high, particularly during the earlier years of the combination's existence. The gradual decrease in the profits in the cigarette branch, without any marked decline in its proportion of the total output, was due in part to the fact that it was necessary in order to hold its position to shift during the latter part of the period to newer brands which, on account of the expense of exploitation, afforded a lower rate of return.

In the cigar branch the combination never acquired any large proportion of the business, and the comparative unprofitableness of this branch stands in sharp contrast with the profitableness of the manufactured tobacco, snuff, and cigarette branches in which it had a high degree of control.

It is evident, therefore, that the high rates of profit shown for the combination in those branches in which it had a high degree of control were in great measure due to monopolistic power.

(3) That for most types of manufactured tobacco the combination's rates of profit were ordinarily more than double those of its competitors, though for a few types it had no advantage.

* * * * * * * *

(4) That selling costs were materially reduced as the volume of the combination's business increased.

(5) That generally there were material decreases in advertising expenditures of the combination after a controlling proportion of the total production had been secured.

(6) That there was a large advance in the cost of leaf tobacco for the combination from 1901 to 1910.

(7) That during 1901 and 1902 the internal-revenue tax was reduced 6 cents per pound on manufactured tobacco, 42 cents per thousand on cigarettes, and 46 cents per thousand on little cigars, but the combination made practically no change in the prices to the jobber, while the prices to the consumer also remained unchanged, so that the combination profited by substantially the whole extent of the tax reduction, though it was presumably intended for the benefit of the consumer.

When the rate of internal-revenue tax on tobacco products is increased, one method of adjustment is to reduce the sizes of the package in which tobacco is permitted to be packed. This is for the purpose of enabling the manufacturer to change the sizes of the packages sold at customary retail prices, and in this way to shift the tax increase to the consumer. Thus, in 1898 when the tax on manufactured tobacco was increased from 6 cents to 12 cents per pound, the statutory sizes of package in which most of the tobacco was packed, namely, 2 ounces, 3 ounces, and 4 ounces, were abolished, and

[illegible] cost less than 25 per cent. In two of the [illegible] producers at a loss. On the other hand, the [illegible] nearly 80 per cent and its profits [illegible] to 7.5 cents.

[illegible] 1903, and in no other branch were the [illegible] one from year to year as small.

[illegible] cigarette branch the combination had practically a [illegible] control from the organization of the American Tobacco Co. In [illegible] a branch the rates of profit were also high, particularly [illegible] earlier years of the combination's existence. The reason [illegible] in the profits in the cigarette branch, without any [illegible] its proportion of the total output, was due in part to the [illegible] was necessary in order to hold its position in [illegible] latter part of the period to newer brands which, on account [illegible]

[illegible] made in early contrast with the restrictiveness of the [illegible] tobacco, snuff, and cigarette branches in which it had [illegible] of control.

[illegible] evident, therefore, that the high rates of profit shown [illegible] combination in those branches in which it had a [illegible] were in great measure due to monopolistic power.

[illegible] that for most types of manufactured tobacco the combination [illegible] profit were relatively more than double those of its competitors, though for a few types it had no advantage.

* * * * * * * *

That selling costs were materially reduced as the volume [illegible] combination's business increased.

[illegible] of the combination after a controlling proportion of the [illegible] had been secured.

That there was a large decrease in the cost of leaf tobacco [illegible] combination from 1901 to 1913.

That during 1901 and 1903 the internal-revenue tax was [illegible] cents per pound on manufactured tobacco, 40 cents per [illegible] cigarettes, and 45 cents per thousand on little cigars. [illegible] combination made practically no change in the prices to the [illegible] while the prices to the consumer also remained unchanged. [illegible] combination profited by substantially the whole [illegible] reduction, though it was presumably intended for the [illegible] consumer.

[illegible] statement is to reduce the prices of the [illegible] commodities to be packed. This is how the [illegible] contributed to a large rate of [illegible] and in this way to shift [illegible] tax. In 1888 when the tax on [illegible] cents to 12 cents per [illegible] which most of the tobacco was

1-2/3 ounce, $2\frac{1}{2}$ ounce, and 3-1/3 ounce sizes substituted.

In 1901, when the tax was reduced 3.4 cents per pound, the statutory packages of 2 ounces, 3 ounces, and 4 ounces, which had been in vogue prior to 1898, were again permitted to be used, but the tax reduction at this time was not sufficient to enable the combination to supply these larger sizes (if the dealers sold at the customary prices and on their usual margins of profit) without greatly reducing its own profits. The wholesale and retail prices were not changed, therefore, and the combination got the advantage from this reduction in tax. In 1902 the tax was again reduced 3.6 cents per pound, but there was no change in the statutory sizes. The packages of 1-2/3 ounces, $2\frac{1}{2}$ ounces, and 3-1/3 ounces in which the bulk of the tobacco was then packed were not abolished, but the combination instead of returning to the old larger sizes and thus reducing its prices per pound, which this second tax reduction would have made feasible, continued to supply these smaller sizes at the prices already current. It profited, therefore, by substantially the whole extent of both tax reductions, though Congress presumably intended the reductions for the benefit of the consumer. Similar conditions existed with respect to the tax reductions on cigarettes and little cigars.

(8) That in 1910 when the internal-revenue tax on manufactured tobacco was increased from 6 cents to 8 cents per pound, on cigarettes from $1.08 to $1.25 per thousand, and on little cigars from $0.54 to $0.75 per thousand, the prices of certain products of the combination were increased as much as the tax both to the jobber and the consumer, so that the burden was shifted to the consumer; while for other products the prices to jobbers and consumers were not increased, so that the burden rested on the combination.

In general, prices were increased both to the jobber and to the consumer on brands of smoking and fine-cut tobaccos, but no changes were made in prices to the consumer on plug, snuff, cigarettes, or little cigars, and only small increases were made in prices to the jobber.

The increase in the tax rate per pound was generally a small part of the profit on the more successful brands, and was therefore generally borne by the manufacturers. If they had reduced the quantities in their retail packages for all sizes, they would have generally more than doubled their profits, and apparently they did not regard this as advisable. For smoking and fine cut, in some cases, they reduced the quantity in a package sold at a customary retail price, and in other cases made no change, and thus increased their profits on some sizes and decreased them on others. Taking all kinds of tobacco products together, however, the tax increase in 1910 was largely borne by the combination.

(9) That there were practically no changes in prices to the consumer for the combination's principal brands of manufactured tobacco, cigarettes, and little cigars from 1901 to July, 1910.

(10) That, while there were practically no changes in prices to the consumer from 1901 to July, 1910, for the combination's principal brands, there were substantial increases in prices to jobbers, thus reducing the margins between these prices.

(11) That the most profitable years of the combination's existence were from 1903 to 1908--the period of low tax, moderate leaf costs, decreased advertising expenditures, and highly monopolistic control.

(12) That the combination for various types or classes of tobacco products developed one or two predominating brands, a policy which tended to promote concentration and economy in manufacture and afforded a greater protection against competition than a multiplicity of brands, but which at the time of dissolution presented difficulties in dividing the business.

Successor Companies

By the term "successor companies" is meant the seven companies that succeeded, under the decree of dissolution, to the domestic tobacco manufacturing business formerly conducted by the combination. The companies are as follows: The American Tobacco Co., the Liggett & Myers Tobacco Co., the P. Lorillard Co., the R. J. Reynolds Tobacco Co., the American Snuff Co, the Weyman-Bruton Co., and the George W. Helme Co. Certain other companies were established by the decree which succeeded to other parts of the business of the combination not discussed in this report, namely, the foreign business, the domestic retail business, and the manufacture of accessory products.

The decree of dissolution allowed a pro rata distribution of the shares of the successor companies among the former shareholders of the combination and extended voting rights to the holders of the preferred stock. This extension of voting rights reduced the proportion of voting stock held by the principal holders thereof, namely, the 29 individual defendants in the dissolution suit, from about 56 per cent in the combination to about 35 per cent, on the average, in the successor companies.

The salient points brought out by this part of the report relative to the business of the successor companies, covering the two-year period following the dissolution of the combination (1912 and 1913), are as follows:

(13) That the several successor companies established in accordance with the plan of dissolution were much larger producers of tobacco products than any of the other companies.

(14) That a comparison of the successor companies' combined proportion of the total output of the country in the various branches of the tobacco business in 1913 with those of the combination in 1910 shows that the combined proportion of the successor companies was less in smoking and in fine cut; more in cigarettes and in snuff, and about the same in plug and little cigars.

(15) That in most branches there was a more equal distribution of business among the successor companies in 1912 and 1913 than there was directly after the dissolution.

(16) That, although there were no important changes in prices, the results for certain branches, particularly smoking and cigarettes, tend to show competition for business in 1912 and 1913 and an effort on the part of the several successor companies to fill in gaps in types of their business in which they were weak, though for certain other branches, particularly snuff, such competition has not been apparent.

(17) That in the snuff branch each of the three successor companies has practically a monopoly in its respective type and to a large extent a distinct sales territory; that the branch is characterized

by unusually high profits and small advertising and selling costs.

(18) That the cost of leaf tobacco used by the successor companies in 1912 and 1913 in the plug, fine-cut, and cigarette branches was less, while in the smoking, snuff, and little-cigar branches it was more, than the cost of that used by the combination in 1909 and 1910.

(19) That the factory costs, other than leaf, of the successor companies in 1912 and 1913 and of the combination in 1909 and 1910 were not materially different.

(20) That almost invariably marked increases or decreases in the volume of particular brands decidedly reduced or increased, respectively, factory costs other than leaf.

(21) That increases in selling cost after the dissolution were general, resulting from the duplication of selling organization and increased overhead expense, due to the division of the business.

(22) That there was a marked increase in the advertising expenditure of the successor companies as compared with that of the combination.

(23) That the aggregate amount of profit of the successor companies in 1913 was slightly less than that of the combination in 1910 in spite of a larger volume of sales.

(24) That the ratios of profit to net receipts less tax for the successor companies in 1913 were , in general, comparatively low in those branches or types in which competition for business was most pronounced, e.g., plug-cut smoking and domestic and blended cigarettes, and very high in those in which competition was slight, e.g., snuff.

(25) That on the book value of the total investment the earnings of the successor companies averaged 12.1 per cent in 1912 and 11.3 per cent in 1913, while the profit accruing to the holders of the common stock in respect to their interest was at a much higher rate.

(26) That on the total cost of investment, assuming that the cost of investment of the successor companies at the date of dissolution was the same as that of the combination in the corresponding branches of the business, the earnings of the successor companies averaged 14.6 in 1913. The earnings of the combination for the corresponding business in 1908 were 17.9 per cent and in 1910 about 17 per cent.

(27) That there have been no material changes in prices to the jobbers since the dissolution of the combination.

(28) That for all principal brands of the successor companies there have been practically no changes in prices to the consumer since the dissolution of the combination.

(29) That the high profits taken in conjunction with the practically unchanged wholesale and retail prices of tobacco indicate that there has been but little competition in price, but this is explained in large part by the customary retail prices and other peculiar price-making conditions of the tobacco trade, including statutory provisions, which make it impracticable in most cases to increase the quantity sold at the customary price.

(30) That for the principal brands of plug tobacco, the manufacturer's cost in 1913 was approximately 50 per cent of the consumer's price, the internal-revenue tax 15 per cent, the manufacturer's profit 10 per cent, and the jobber's and retailer's margin 25 per cent; that for the principal smoking and cigarette brands the manufacturer's cost in 1913 was approximately 45 per cent of the consumer's price, the internal-revenue tax 20 percent, the manufacturer's profits 10 per cent, and the jobber's and retailer's margin 25 per cent; and that for a number of the snuff brands the manufacturer's cost in 1913 was approximately 35 per cent of the consumer's price, the internal-revenue tax 15 per cent, the manufacturer's profit 20 per cent, and the jobber's and retailer's margin 30 per cent.

OTHER COMPANIES

It was impracticable to obtain price, cost, and profit data from all companies, other than the combination and successor companies. However, data were secured from 64 of the other principal concerns manufacturing plug and smoking tobaccos, cigarettes, and cigars.

In respect to production, however, the total output of the country is available from the records of the Bureau of Internal Revenue, and these figures are used below in computing the percentages of the aggregate production of all other companies than the combination and successor companies.

In 1913 the plug output of the companies, other than the successor companies, covered by the investigation represented 65 per cent of the total production of all such other companies, the smoking output 78 per cent, and the cigarette output 50 per cent.

The salient points brought out by this part of the report relative to the business of companies other than the combination and successor companies, before and since the dissolution of the combination, are as follows:

(31) That for companies other than the combination and successor companies there were marked decreases in the proportions of their collective output in the plug, smoking, snuff, cigarette, and little-cigar branches, from 1905 to 1913.

(32) That compared with both the combination and successor companies the manufacturing costs of the other companies covered by the investigation were extremely high in practically all branches.

(33) That compared with either the combination or the successor companies the selling costs per unit of product of other companies investigated were extremely high in all branches.

(34) That the larger margins above manufacturing and selling costs of the combination and successor companies enabled them in most branches to spend from three to five times as much per unit of product for advertising or competitive purposes as the other companies investigated and at the same time to obtain practically the same or even greater rates of profit.

(35) That compared with the combination and successor companies the other companies investigated made an exceedingly poor showing of profits and that there was a marked decrease in profits of these companies in navy plug and Turkish cigarettes since the dissolution of the combination.

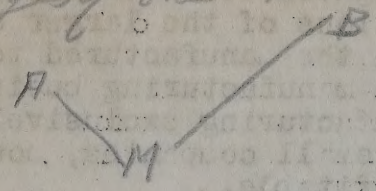
(36) That among companies investigated other than the Combination and successor companies the operations of the larger ones were, as a rule, the most profitable; and, in the manufactured tobacco business, those doing a general tobacco manufacturing business usually were more prosperous than those manufacturing exclusively one class of product. The operations of certain small companies, however, having especially popular brands were also profitable.

(37) That the companies other than the combination and successor companies which were the most successful in increasing their output were the ones that adopted the coupon advertising system, i.e., the method of giving coupons, which are redeemable in either cash or articles of merchandise, as an inducement for trade.

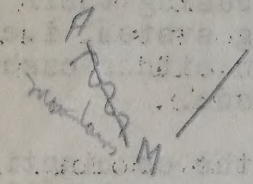
(38) That the independent companies, like the combination, did not generally reduce prices in 1901 and 1902, during which time the revenue tax was materially reduced.

(39) That the independent companies, like the combination, generally increased prices on smoking tobacco in 1910 to meet the increase in tax rate, and that the increase in price in most cases exceeded the increase in tax, but, like the combination, they did not increase prices on plug, cigarettes, or cigars.

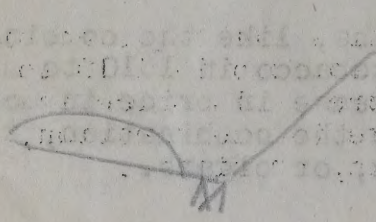
Advantages of one ~~food~~ over others



1. Manners



2. Low Cost of Transportation



= 3 Competition

= 4 Low Cost of Production

Daggett 368-382
Locklin 93. — 112-113